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This report contains historical information and may contain certain forward-looking statements that relate to future events or future performance. The forward-looking statements are based upon management's current expectations and assumptions as to a number of factors, including the risks, uncertainties and other factors as described in BC Ferries' Management's Discussion & Analysis contained herein and certain of the other BC Ferries documents available at www.sedar.com. These forward-looking statements are made as of today's date and are based upon information currently available to management and BC Ferries assumes no obligation to update or revise them to reflect new events or circumstances. If management's expectations and assumptions prove to be incorrect, or factors change, then actual results could differ materially from the forward-looking information contained in this report.



British Columbia Ferry Services Inc.

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The addition of our new Super C-class ferries, beginning with the arrival of the *Coastal Renaissance* in December, is more than just the single biggest fleet upgrade in our history. It's the beginning of a new era for BC Ferries—an era marked by world-class vessels and renewed relationships with our customers and travellers from around the world. Best of all, it's a new era built on the pride and enthusiasm of our employees.

9





Who We Are

BC Ferries is one of the largest ferry operators in the world, providing year-round vehicle and passenger service on 25 routes to 47 terminals, with a fleet of 37 vessels. We are an essential transportation link that connects coastal communities and facilitates the movement of people, goods and services throughout British Columbia. Our 4,000 employees provide the best in safety and service every day as we transport more than 21 million passengers and 8.5 million vehicles each year.

Our Vision

To provide a continuously improving west coast travel experience that consistently exceeds customer expectations and reflects the innovation and pride of our employees.

Our Mission

To provide safe, reliable and efficient marine transportation services which consistently exceed the expectations of our customers, employees and communities, while creating enterprise value.

Corporate Profile

Our Values

Safety

Ensure that the safety and security of our customers and staff is a primary concern in all aspects of doing business.

Quality

Be motivated by customer expectations in providing quality facilities and services.

Integrity

Be accountable for all our actions and ensure we demonstrate integrity in our business relations, utilization of resources, treatment of our customers and staff, and in the general conduct of our business.

Partnerships

Work openly and constructively with our various business and community stakeholders to exceed the expectations of our customers and advance each other's interests.

Environment

Ensure that environmental standards are maintained.

Employees

Always deal from a position of honesty, integrity and mutual respect, and ensure that our employees develop to their full potential.

Our Goals

In support of our vision, we are focused on five key goals, none more important than safety.

Safety

To continuously improve the safety of our operations inclusive of vessels, terminals and facilities.

Operational Reliability

To continuously improve the operational reliability of vessels, terminals and facilities.

Continuous Improvement

To be better at everything we do.

Value For Money

To continuously improve value to our customers at every point along the customer experience chain.

Financial Integrity

To achieve key financial targets, ensuring that sufficient capital and retained earnings are available to revitalize our fleet, facilities and infrastructure, while minimizing fare escalation.

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AUG 12 2008



Elizabeth J. Harrison, QC, Chair,
Board of Directors

A Message From The Chair

As we continue to focus on the safety and efficiency of our operations, we have made considerable progress with our major capital and operational renewal program.

This year, the Board, together with the employees of BC Ferries, celebrated the arrival of the *Coastal Renaissance*—the first of three new Super C ships to join the fleet. It was a milestone event for all of us and one that highlighted the dedication and pride of our employees who worked diligently to bring these ships into service. The *Coastal Renaissance*, along with sister ships *Coastal Inspiration* and *Coastal Celebration*, will provide a truly outstanding travel experience for our customers and crew for many years to come.

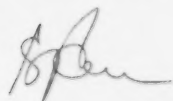
In addition to welcoming the Super Cs, construction continued on two other new vessels, the *Island Sky* and *Northern Expedition*, and we continued our extensive program to upgrade our existing fleet and terminals and provide an enhanced travel experience for our customers.

I join the British Columbia Ferry Services Inc. Board in sending a special thank you to outgoing Board members Sandy M. Fulton, John R. Henderson, Doreen J. Hewitt and Robert W. McCaskill for their years of valuable service.

We also welcome new members Mark L. Cullen, Christopher C. Gardner, Donald P. Hayes, Brian G. Kenning and Wayne H. Stoilen to the Board. Messrs. Gardner, Hayes and Kenning have also been appointed to the Board of Directors of B.C. Ferry Authority. Together, they bring a wealth of additional experience and knowledge to the Board.

On behalf of the Board, we congratulate and thank the employees of BC Ferries for their continued professionalism, commitment to safety and dedication to customer service excellence.

We look forward to the year ahead.



Elizabeth J. Harrison, QC
Chair

A Message From The President & CEO

With a new safety program, outstanding employees, spectacular new ships, enhanced terminals and new products and services, we continued to make significant advancements in all areas of the company this past year.

The core of our business is our employees, who worked throughout the year to ensure that our ships ran safely, our terminals operated efficiently and our customers continued to receive outstanding service. Their hard work and expertise were evident in all areas of our business.

In keeping with our commitment to safety, during the year we continued to develop a new safety program in partnership with the BC Ferry & Marine Workers' Union. Together, we are building on our current practices to ensure that we provide the best in safety for our passengers and employees.

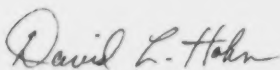
It was with great pride in December 2007 that we welcomed the *Coastal Renaissance*, the first of three new Super C-class vessels, followed by the *Coastal Inspiration* in March 2008 and the *Coastal Celebration* in June 2008. These ships will provide a world-class travel experience and safe, reliable service to local residents and visitors to B.C. for decades to come.

In addition to our new Super C ships, this past year we continued work on two more new ships, the *Island Sky* and the *Northern Expedition*, which will join the fleet in fall 2008 and spring 2009, respectively. We also continued our extensive, company-wide asset revitalization program, with significant investments in our existing fleet and new development at our terminals.

During the year, we continued to meet with our stakeholders on matters of mutual interest, including the second performance term of the Coastal Ferry Services Contract, which began on April 1, 2008. We also continued to support our communities through a dedicated community relations team and a wide range of partnerships, donations and sponsorships.

While we faced some business challenges this past year, including record high fuel prices, we also continued to explore new business opportunities. In addition to taking over management of the Sidney International Ferry Terminal and actively pursuing new commercial customers, we signed a lease to open a travel centre at the new Fairmont Pacific Rim property in downtown Vancouver. We look forward to building our profile in the Lower Mainland when the travel centre opens in 2009.

Above all, this past year delivered a new kind of travel experience for our customers, with new ships, enhanced terminals and new products and services. With even more new ships on order, major upgrades underway and a commitment to excellence in all areas of our business, we are proud to provide a unique and memorable experience to the millions of customers who travel with us each year.



David L. Hahn
President & Chief Executive Officer



David L. Hahn
President & Chief Executive Officer



Performance Measures

Measuring Our Success

The Board of Directors and management of BC Ferries have implemented comprehensive long-term performance measures to gauge the progress of the business and its commitment to continuous improvement. Below are our performance measures for years ended March 31:

Performance Measures	2005	2006	2007	2008
Employee Safety (employee injury frequency rate X the severity rate divided by 1,000)	2.71	2.02	3.08	2.84
Passenger Safety (number of passenger injuries per one million passengers)	13.67	13.58	11.31	11.93
Reliability (round trips divided by scheduled round trips)	99.69%	99.48%	99.66%	99.63%
On-time Performance (departures within ten minutes of departure time)	84.3%	85.3%	86.3%	86.5%
Asset Reinvestment (weighted average age of vessels by gross registered tonnes)	28.9 years	29.5 years	25.4 years	23.8 years
Customer Satisfaction Rating	88%	86%	89%	88%
Cost per passenger	\$17.56	\$16.45	\$17.07	\$18.35
Earnings per full-time equivalent (\$ thousands)	\$32.53	\$36.94	\$37.54	\$37.84
Earnings before interest, taxes, depreciation and amortization (\$ millions)	\$112.0	\$128.1	\$123.6	\$137.0
Net Earnings (\$ millions)	\$39.8	\$49.9	\$48.8	\$37.1

safety is #1



Safety & Security

At BC Ferries,
nothing is more
important than
safety.

Every Day. Every Way

At BC Ferries, our first priority is to ensure the safety of our customers and employees.

As part of our dedication to safety excellence, this past year we launched SailSafe, a joint initiative between BC Ferries and the BC Ferry & Marine Workers' Union that reflects our common commitment to safety. Importantly, SailSafe is driven by our employees who work to continuously improve current practices and make sure that safety is our first priority each and every day.

To ensure that our crews are properly trained and ready to respond to any emergency situation, we provided more than 14,000 operational training days this past year, up from 11,000 days the previous year. This training included more than 1,300 days of training on marine evacuation systems. We also introduced several new operational training programs, including new engine room resource management programs, a passenger safety management program, new security training and an English as a Second Language program.

We continued our program to install Voyage Data Recorders (VDRs) on all of our ships. To date, VDRs have been installed on 23 vessels. By early 2009, all ships in our fleet will be outfitted with VDRs, while newly constructed vessels will be outfitted during construction.

Security

We continue to work closely with Transport Canada and other agencies to enhance safety and reduce regulatory uncertainty. We are also working with these groups regarding the implementation of the *Canada Shipping Act, 2001* and the Transport Canada Domestic Ferry Marine Transportation Security Regulations.

Building on the company-wide security plan developed in 2007, this past year we completed security plans and infrastructure designs for our terminals and continued developing security plans for each vessel. Through the Marine Security Contribution Program, we are eligible for \$3.8 million in federal funding to offset the costs of perimeter security, access control measures and training for Swartz Bay, Tsawwassen, Departure Bay and Duke Point terminals. We anticipate making future applications to offset costs of security upgrades to vessels and terminals.



Our People

We are
committed
to developing
a performance-
based workforce
that is service
oriented and
focused on
continuous
improvement.

Our Employees

Our employees continued to work hard to ensure the safe and efficient operation of our ships and terminals, and to provide outstanding service to the millions of customers who travelled with us last year. It is through their ongoing dedication and commitment to excellence that we are able to achieve our corporate goals and deliver a continuously improving travel experience for all of our customers.

Last year, as part of our efforts to ensure that we are developing a skilled workforce that is performance-based, service oriented and focused on continuous improvement, we provided a wide range of career and management development programs, including 1,275 training days through our BC Ferries Academy. We also continued with our expansive career and management development programs, as well as our Respect in the Workplace program—one way we provide a safe and positive work environment for all employees.

In order to ensure that all of us at BC Ferries plan our day-to-day work in support of the overall corporate strategy and contribute to the success of our business, this past year we introduced a new Performance Management & Objective Setting Workshop. We further developed our comprehensive succession plan, provided financial support to employees through our tuition reimbursement program and offered 60 post-secondary scholarships to eligible dependants of our employees.

In the coming year, we look forward to providing additional training opportunities, including an Advanced Leadership Program, and to developing new and innovative programs as we continue to support our employees' career and personal development goals.

♻️ Recycling ♻️

NEWSPAPERS

CANS
PLASTICS

GARBAGE

Environment

Doing Our Part

As a company, we are taking steps to reduce our environmental footprint. Since 2003, we have reduced our annual fuel consumption through a variety of fuel saving measures, including resurfacing vessel hulls, installing new, more fuel-efficient engines on some vessels and fuel monitoring systems on others.

The reduction of Greenhouse Gas Emissions is a high priority at BC Ferries. Accordingly, we have undertaken an anti-idling campaign for vehicles at our terminals and onboard our vessels. We are using low sulphur fuel on all of our ships and are actively researching alternative fuels, such as biodiesel. We are also replacing our existing ground transportation vehicles with more fuel-efficient and lower emission vehicles. To date, we have purchased 11 propane-powered units to replace gasoline-powered baggage vans and five electric-powered vehicles to replace gasoline-powered service vehicles.

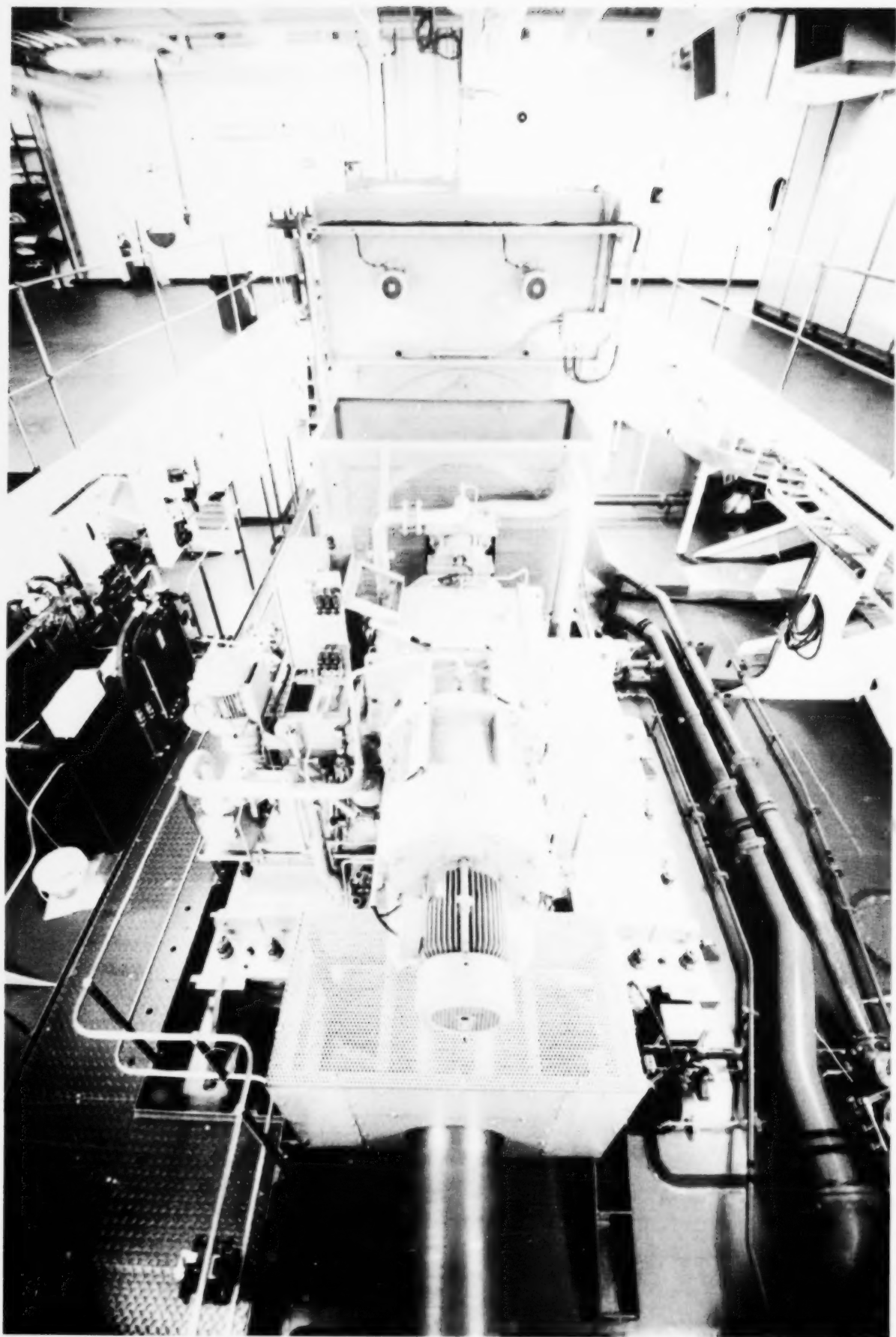
We have also replaced chemical cleaning and maintenance products with more environmentally-friendly solutions, including a de-icing product that is less corrosive than road salt, and replaced conventional paper towels and toilet paper with Environmental Choice™ certified products.

Our comprehensive Waste Management program ensures that we dispose of all used materials in an environmentally responsible manner. In addition to recycling beverage containers, plastics, cardboard and newsprint, we recycle used cooking oil and spent fluorescent tubes and batteries. We also divert approximately 1,900 kg of compostable material from the landfill every week through our organic composting program.

Our fleet-wide Hazardous Waste Management program ensures that all oily wastes and spent solvents and paints are collected and processed by certified third parties. All oily waters are either processed through onboard Oily Water Separators or collected for appropriate disposal.

During the year, as part of the continuous upgrading of vessels, a new sewage treatment system was installed on the *Spirit of British Columbia*. Similar systems are scheduled to be installed on select vessels in the coming year. This ongoing project is being undertaken to ensure compliance with federal marine sewage discharge regulations that come into effect in 2011. We also test sewage effluent from vessels fitted with onboard marine sanitation devices and have shore-based sewage treatment systems monitored monthly by third-party consultants.

We are
implementing
a variety of
initiatives to
minimize our
environmental
footprint.



Our Ships

A Super Year

A new era in ferry travel began at BC Ferries on March 8, 2008 when the *Coastal Renaissance*, the first of three new Super C-class ships built at Flensburger Schiffbau-Gesellschaft (FSG) shipyard in Germany, officially entered service on the Departure Bay – Horseshoe Bay route. On March 25, 2008, following a 10,000 nautical mile journey from Germany, the second Super C, the *Coastal Inspiration*, arrived in British Columbia before entering service on the Duke Point – Tsawwassen route on June 16, 2008. The third ship, the *Coastal Celebration*, arrived in B.C. on June 18, 2008 and is expected to enter service on the Swartz Bay – Tsawwassen route by fall 2008. The \$542 million Super C-class project is currently on schedule and under budget.

These three new ships are the largest double-ended ferries in the world, each measuring 160 metres in length and carrying up to 1,650 passengers and crew and 370 vehicles. The state-of-the-art ships operate at a service speed of 21 knots using a fuel-efficient diesel-electric propulsion system and have been certified by the American Bureau of Shipping (ABS) as meeting the requirements of its 'COMF+' and 'HAB' class notations—meaning the ships offer enhanced passenger comfort in terms of noise levels, climate control and lighting levels. The *Coastal Renaissance*, *Coastal Inspiration* and *Coastal Celebration* are the first ships in our fleet to receive this new designation and among the first in the world to be certified by ABS under this new classification.

New ships and an upgraded fleet are the cornerstone of an unparalleled travel experience for our customers.

The Super Cs are also designed to exceed the environmental standards of the International Maritime Organization (IMO) and the US Environmental Protection Agency (EPA). Reductions in energy use come from innovative design and applications of specific energy-saving technologies. When all three new Super C-class vessels are in operation, we expect to realize a reduction in our annual fuel consumption, after redeployment and retirement of existing vessels.

In keeping with the Canadian Transportation Agency's guidelines for accessibility for persons with disabilities, these new ships feature three elevators, wide lanes and a special parking area at each end of the vehicle deck, accessible washrooms on both passenger decks and accessible seating in all food service areas. There are also visual elements for the hearing impaired and signage that is compliant with international standards.

With two passenger decks offering food and retail services, floor to ceiling windows providing panoramic views in the dining areas and more outside deck space than any other ferry in the fleet, the Super Cs will deliver an unparalleled travel experience for our customers and crew for many years to come.



More New Ships Coming Soon

In addition, construction continued on two more new ships. In December 2007, we completed the vessel design for the *Northern Expedition*, a new vessel under construction at FSG shipyard that will replace the 42-year-old *Queen of Prince Rupert* on our northern routes. This 150-metre vessel, which will be launched in September 2008 and is expected to be in service by spring 2009, will have 55 staterooms and accommodate 130 vehicles and 600 passengers. The \$200 million project is currently on schedule and on budget. Together, the *Northern Expedition* and the *Northern Adventure*, a new vessel added on our northern routes in 2007, will deliver a cruise-like travel experience on the north coast of British Columbia.

On January 4, 2008, the hull structure of the *Island Sky* was completed. This new ship, a 102-metre vessel designed for up to 600 passengers and 125 vehicles, will initially operate on the Earls Cove – Saltery Bay route on the Sunshine Coast. The *Island Sky* will feature state-of-the-art lifesaving and firefighting systems, as well as a variety of amenities, including a lounge and snack bar for passengers. Once the vessel is in service, it will replace the *Queen of Chilliwack* and make way for the retirement of the 48-year-old *Queen of Tsawwassen*. The \$46 million contract with Vancouver Shipyards for the construction of the *Island Sky* constitutes the majority of the total project budget of \$57 million.



Rebuilding Our Fleet

On June 27, 2007, the *Queen of Alberni* returned to service on the Duke Point - Tsawwassen route following an extensive \$39 million upgrade to prepare the ship for another 20 years of service. The upgrade included significant mechanical and safety improvements, as well as a host of new customer amenities, ranging from expanded onboard food services to a coin-operated shower for the convenience of the long-haul truckers who frequently travel on the Duke Point - Tsawwassen route.

This past year, we also began a \$55 million upgrade to the *Queen of New Westminster* to prepare the ship for an additional 13 years of service, and commenced the final phase of a \$13 million upgrade on the *Quinitsa*. In addition, Deas Pacific Marine, our maintenance and refit facility, completed refits and maintenance on 26 vessels this past year to ensure our ships continue to run as safely and efficiently as possible.

With three new Super Cs and the *Island Sky* joining the fleet in 2008, four older vessels, ranging in age from 45 to 48 years, will be retired. The *Queen of Tsawwassen*, one of our original vessels, along with the *Queen of Esquimalt*, *Queen of Saanich* and *Queen of Vancouver* will leave the fleet by fall 2008.



Terminal Upgrades

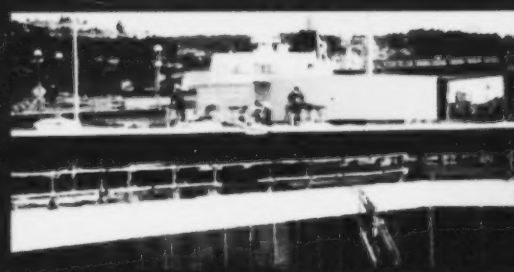
Upgraded terminals provide a complete travel experience for our customers.

Investing in Our Terminals

To ensure we provide an outstanding end-to-end travel experience for our customers, we plan to invest approximately \$250 million in our terminals for building and marine structure upgrades over the next five years.

This past year, we invested \$54.5 million in terminal upgrades, including \$26.6 million in terminal marine structures and \$27.9 million for terminal and building upgrades and equipment. We completed significant upgrades at Horseshoe Bay and Departure Bay to accommodate the new Super C-class vessels; finished a \$2.1 million project at Alert Bay to expand the holding compound, replace the waiting areas and add a pickup/drop-off lane; and began a \$9.2 million project at Swartz Bay terminal to expand the pre-ticket area and add new ticket booths.

Additionally, at Departure Bay terminal, we completed \$17.8 million of a \$40.7 million project to expand the holding compound, the short-term parking areas and the pickup/drop-off zone, and to construct a new retail building, ticket building, waiting room and washrooms. By summer 2008, the new 5,600 sq ft Nanaimo Quay will open at the Departure Bay terminal to offer customers a wide range of food and retail options.





Travel Experience

More travel options and enhanced services invite customers to experience the difference with BC Ferries.

Improving the Customer Travel Experience

The results of our 2007 annual customer satisfaction survey showed that 88 per cent of our customers were satisfied with their BC Ferries experience, up from 83 per cent in 2002. When asked if they thought service at BC Ferries was better, worse or the same as in 2003, 37 per cent of respondents said service was better in 2007. As in previous years, our employees continued to receive high scores for courtesy and professionalism, with customers also giving high ratings for the safety of our operations, the usefulness of the website, ease of using online reservations, highway signage and the cleanliness of our ships and terminals.

Travel Planning and Booking

To further improve the ease of ferry travel, we introduced the new BC Ferries Experience™ Card: an electronic card similar to a debit or gift card that can be redeemed for travel instead of using cash, credit cards or prepaid tickets. The card also provides loss protection for customers, as well as access to specials and reduced fares. We also launched an enhanced website in June 2008. The site offers improved fare and schedule pages, interactive trip planning, sailing time availability, price information, reservations and automatic fare calculations.

Late-night Sailings and Special Offers

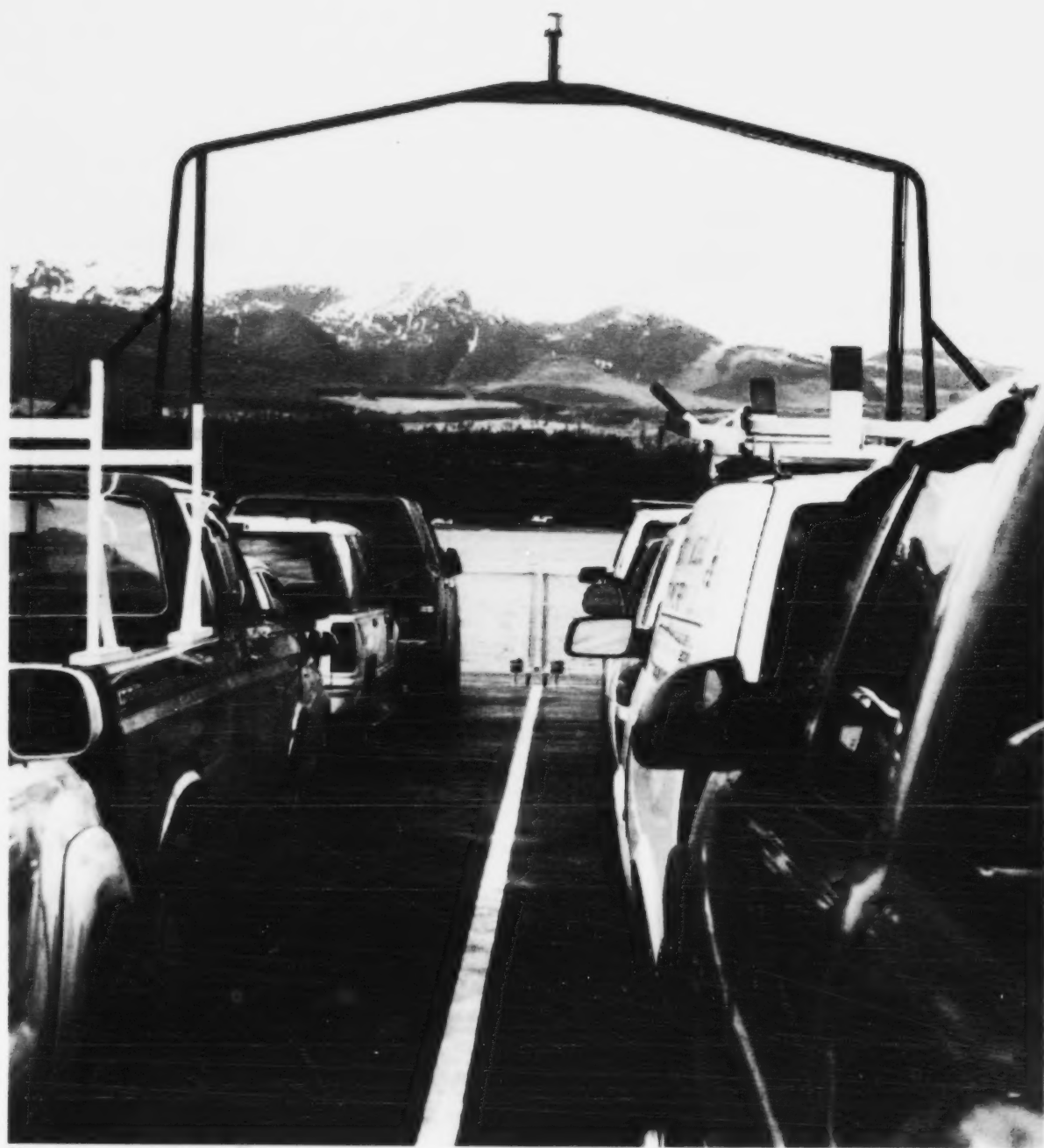
To provide customers with the option of returning to Vancouver Island on the same day of evening events on the Lower Mainland, we added late-night sailings for special events, including BC Lions games, the Steve Nash Foundation Charity Classic and the Vancouver Whitecaps/Beckham event. We also continued to offer various promotions and travel incentives to our customers, including CoastSaver fares that offer travellers savings up to 40 per cent on specific sailings.

Enhancing the Onboard Experience

As part of our effort to enhance the onboard travel experience, last summer we introduced an expanded Coastal Naturalist program on more than 1,300 sailings between Tsawwassen – Swartz Bay and Horseshoe Bay – Departure Bay. Customers on select sailings experienced an educational and entertaining presentation about the marine life, geography and history of the southern Strait of Georgia and Gulf Islands region. For the enjoyment of our customers at our Swartz Bay and Tsawwassen terminals, we introduced a new Coastal Awareness presented by Chevron interactive exhibit.

New Coastal Sensations and Healthy Choices

As the fifth largest restaurant in British Columbia by sales volume, we are committed to providing a wide range of food and beverage options to our customers. Adding to our already expansive menu, this past year we introduced new Healthy Choices options and a new Coastal Sensations menu on a number of our ships. Now, in addition to onboard favourites such as sandwiches, wraps and sushi, White Spot Triple-O hamburgers and a selection of fresh salads, customers can choose from baked wild salmon, pork tenderloin with pasta, pakoras and samosas and several trans fat-free options. In June 2008, we partnered with the Heart and Stroke Foundation and introduced six new menu items that earned the Health Check™ symbol.



Our Communities

We are committed
to the communities
we serve.

Giving Back to Our Communities

We recognize the important role we play in British Columbia's coastal communities and welcome the opportunity to give back to our customers and the communities we serve.

This past year, we continued our partnership with Sport BC, donating more than \$110,000 to KidSport™ to give underprivileged kids an opportunity to play sports. Other major community sponsorships included the Haida Child & Family Services Society Homecoming celebration, 2007 Disability Games in Powell River, 2008 All Native Basketball Tournament in Prince Rupert, BC Lions, 2007 BC Bike Race, Royal BC Museum and the Art Gallery of Greater Victoria.

In addition, the community-mindedness of our employees was exemplary this past year as they raised more than \$100,000 for the 2007 Greater Victoria United Way Campaign and held five employee-led community breakfasts to feed 300 less fortunate members in our communities. We also had the most employees of any company in B.C. participate in the Great Canadian Shoreline Cleanup. Together, our employees removed more than 2,700 kg of debris from shorelines in and around the communities we serve.

Stakeholder and First Nations Relations

Throughout the year, we continued to meet regularly with our Ferry Advisory and Terminal Liaison Committees, local governments and First Nations on matters of mutual interest. In particular, extensive discussions were held with our stakeholders regarding the Second Performance Term of the Coastal Ferry Services Contract, which began on April 1, 2008.

The relationship between our Accessibility Advisory Committee and the BC Coalition of People with Disabilities continues to deliver valuable input into the design of new vessels and the development of our terminals. The Coalition's input into the design of our new Super C-class ships resulted in significant improvements for passengers with disabilities, including dedicated parking areas, elevators to all three passenger decks, wider walkways, dedicated tables in our restaurant facilities and visual elements for the hearing impaired.



We continuously seek new opportunities to grow our business and build an even stronger company.

Terminal Management Services

In March 2007, we established Pacific Marine Ventures Inc. ("PMV") as a wholly owned subsidiary of BC Ferries to pursue strategic business opportunities, including terminal management opportunities outside of our current system. In September 2007, PMV assumed management of the Sidney International Ferry Terminal. Under a 40-year lease, PMV is managing and developing the town's ferry terminal with a focus on developing new business opportunities. Washington State Ferries continues to be the primary user of the facility with its service to Anacortes, Washington. PMV is continuing to pursue other management services opportunities.

Vancouver Travel Centre Opening 2009

To increase our business in the Lower Mainland, expand our new market reach and further develop travel and tourism partnerships, in February 2008 we signed a lease to develop a 2,700 sq ft travel centre in the new Fairmont Pacific Rim property currently under construction in downtown Vancouver. We anticipate the BC Ferries travel centre will open in late 2009.

Commercial Sales Growth

To further increase our capacity in the commercial sector, we have assigned one new Super C-class vessel to each major route between the Lower Mainland and Vancouver Island. As a result, the *Coastal Inspiration* has joined the recently-upgraded *Queen of Alberni* on the Duke Point - Tsawwassen route – the route most frequently used by commercial truckers. Additionally, our commercial sales team is continuing to actively pursue new business and is implementing new integrated sales solutions and enhanced services for our commercial customers.



We continue to invest all retained earnings into the largest asset renewal program in our company's history.

As all of our retained earnings are invested back into the company, it is vital that we meet our financial targets to ensure that we have the necessary capital to revitalize our fleet, terminals and other infrastructure.

This past year, we posted net earnings of \$37.1 million, down from net earnings of \$48.8 million before extraordinary gain the previous year. The decline in net earnings is attributable to significant new assets that came into service during the year. As we continue to invest all of our retained earnings into our asset renewal program, amortization and financing costs will continue to increase. Consequently, we expect our future earnings will continue to decrease in the near term, before improving. This is consistent with our long-term financial plan.

Capital expenditures in fiscal 2008 totalled \$452.5 million, up from \$262.6 million the previous year. Expenditures included \$382.8 million for new vessels, vessel upgrades and modifications; \$26.6 million in terminal marine structures; \$27.9 million in terminal and building upgrades and equipment; and \$15.2 million in computer hardware and software development.

On January 11, 2008, we completed a \$200 million 30-year senior secured bond issue. The net proceeds were used to fund capital expenditures and the related debt service reserve and for general corporate purposes. In February 2008, coinciding with the conditional acceptance of the *Coastal Inspiration*, we received \$90 million in proceeds under a loan agreement with KfW, a German export credit bank. In May 2008, under a separate loan agreement, we received a further \$90 million in proceeds from KfW, coinciding with the conditional acceptance of the *Coastal Celebration*. The net proceeds from these loans were used to partially finance the purchase of our Super C-class vessels.

We continued to be challenged by the high cost of fuel with our annual fuel costs rising to \$86.8 million in 2007/08 compared to \$45.9 million in 2003. As fuel costs continue to escalate, our annual costs could potentially reach \$140 million in 2008/09.

In addition to the impact of high fuel prices on our operations, we are concerned about the resulting impact on our customers' travel decisions. The cost of fuel could translate into significant fuel surcharges and result in unprecedented total tariff levels. Although our traffic levels have not shown any significant effect from the higher tariff costs, the combination of fuel surcharges and the significant increase in the price of motor vehicle fuel could result in a decline in personal travel choices in the future.

While we are continuing to do everything we can to reduce our fuel consumption, we recognize that fuel surcharges are necessary to address the record high price of fuel. As a result, on August 1, 2008, a fuel surcharge of 10.3 per cent for major routes connecting Vancouver Island to the Lower Mainland, 17.6 per cent on the minor routes servicing the Southern and Northern Gulf Islands and 9.2 per cent on the Horseshoe Bay - Langdale route will be applied to all fares.

Alternative Service Providers

Under the *Coastal Ferry Act*, BC Ferries is required to seek additional or alternative service providers on designated routes through fair and open competitive processes. In accordance with the Act, we are testing the market to determine whether another operator, under contract to BC Ferries, could provide safe, reliable and high-quality service that is more cost-effective.

Second Performance Term

Our tariffs are regulated and our service levels are monitored by the British Columbia Ferries Commissioner, who establishes price caps over a performance term. Our first performance term ended March 31, 2008 and our second performance term ends March 31, 2012.

Under the Commissioner's order for the second performance term, the price cap increase, which started from a level that included fuel surcharges in place at March 31, 2008, was 7.3% on the major routes and 4.0% on all other routes effective April 1, 2008.

On each subsequent April 1 of the four-year term, the price cap on the major routes will increase by 2.7% plus 0.49 times the latest reported annual increase in the Consumer Price Index (British Columbia). On all other routes, the price cap increase on each subsequent April 1 will be 5.7% plus 0.73 times the Consumer Price Index (British Columbia).

BC Ferries' Fleet

MAJOR VESSELS PASSENGERS 450-2,052 | CREW 21-48 | AUTOMOBILE EQUIVALENTS 286-470



Spirit of British Columbia 1993



Spirit of Vancouver Island 1994



Coastal Renaissance 2007



Queen of Alberni 1976



Queen of Coquitlam 1976



Queen of Cowichan 1976



Queen of Esquimalt 1963



Queen of New Westminster 1964



Queen of Oak Bay 1981



Queen of Saanich 1963



Queen of Surrey 1981



Queen of Vancouver 1967

INTERMEDIATE AND SMALL VESSELS PASSENGERS 133-977 | CREW 4-35 | AUTOMOBILE EQUIVALENTS 16-192



Queen of Burnaby 1965



Queen of Nanaimo 1964



Queen of Tsawwassen 1960



Skeena Queen 1996



Queen of Cumberland 1992



Queen of Capilano 1991



Mayne Queen 1965



Bowen Queen 1965



Powell River Queen 1965



Quinlan 1982



Quinsia 1977



Ruper 2006



Rialto 1977



X-Whaler 1973



Kwaka 1975



Howe Sound Queen 1964



Lache 1969



North Island Princess 1958



Quadra Queen II 1969



Tenaka 1964

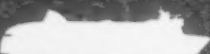


Nimpkish 1973



Mill Bay 1956

NORTHERN VESSELS PASSENGERS 374-504 | CREW 26-40 | AUTOMOBILE EQUIVALENTS 80-115



Northern Adventure 2004



Queen of Chikilack 1978



Queen of Prince Rupert 1986

IN SERVICE 2008/2009



Coastal Inspiration June 2008

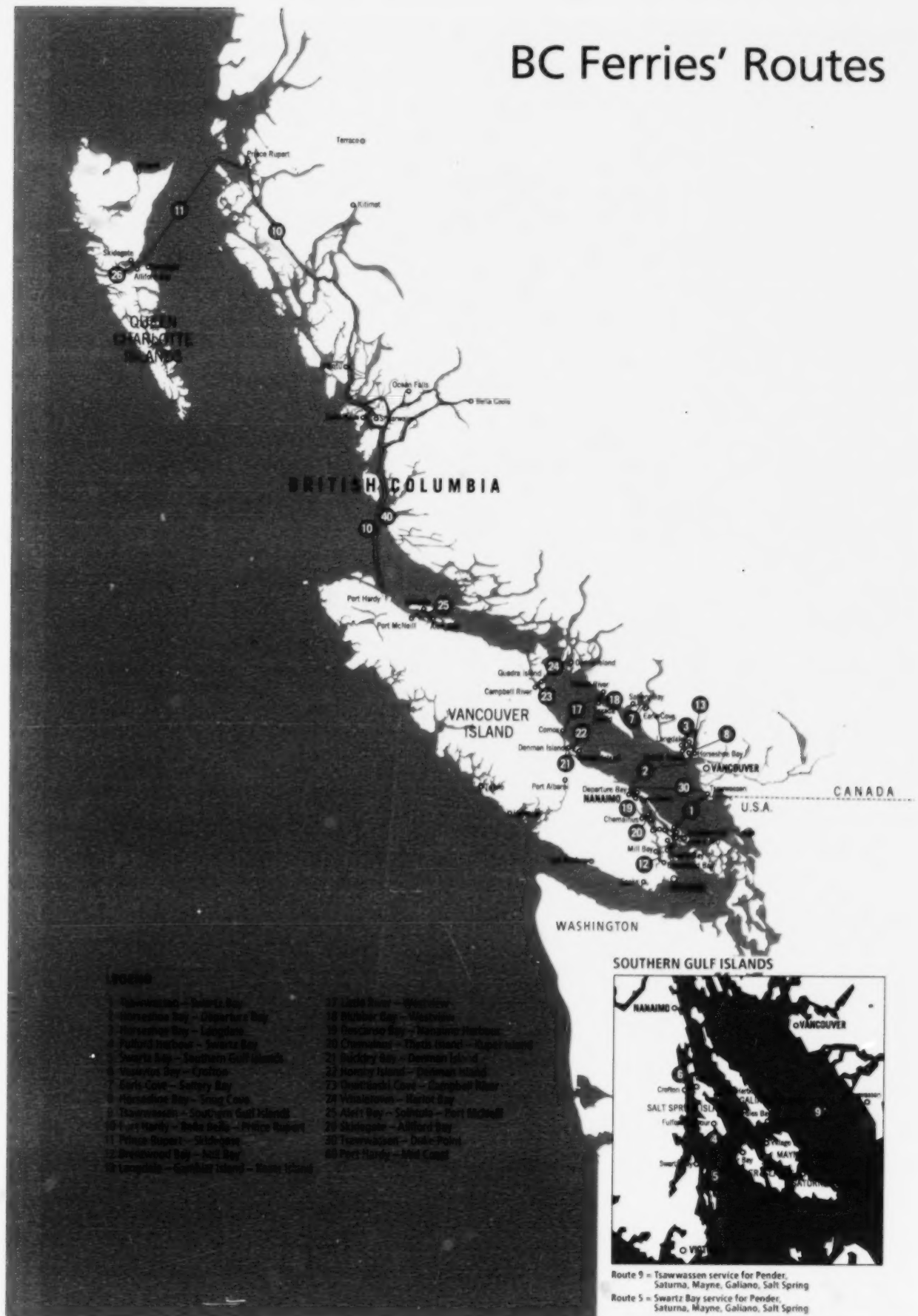


Coastal Celebration Fall 2008



Island Sky Fall 2008

BC Ferries' Routes





BC Ferries' Routes



LEGEND

- | | |
|---|---|
| 1 Tsawwassen – Swartz Bay | 17 Little River – Westview |
| 2 Horseshoe Bay – Departure Bay | 18 Blubber Bay – Westview |
| 3 Horseshoe Bay – Langdale | 19 Descanso Bay – Nanaimo Harbour |
| 4 Fulford Harbour – Swartz Bay | 20 Chemainus – Thetis Island – Kuper Island |
| 5 Swartz Bay – Southern Gulf Islands | 21 Buckley Bay – Denman Island |
| 6 Vesuvius Bay – Crofton | 22 Hornby Island – Denman Island |
| 7 Earls Cove – Saltery Bay | 23 Quathiaski Cove – Campbell River |
| 8 Horseshoe Bay – Snug Cove | 24 Whaletown – Heriot Bay |
| 9 Tsawwassen – Southern Gulf Islands | 25 Alert Bay – Sointula – Port McNeill |
| 10 Port Hardy – Bella Bella – Prince Rupert | 26 Skidegate – Alliford Bay |
| 11 Prince Rupert – Skidegate | 30 Tsawwassen – Duke Point |
| 12 Brentwood Bay – Mill Bay | 40 Port Hardy – Mid Coast |
| 13 Langdale – Gambier Island – Keats Island | |

SOUTHERN GULF ISLANDS



Map 1: Tsawwassen to Swartz Bay
Map 2: Swartz Bay to Southern Gulf Islands
Map 3: Swartz Bay to Port Hardy
Map 4: Port Hardy to Bella Bella

FINANCIALS

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Management's Discussion & Analysis of Financial Condition and Results of Operations for the fiscal year ended March 31, 2008

Dated May 13, 2008

The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. as of May 13, 2008. This should be read in conjunction with our audited consolidated financial statements and related notes for the years ended March 31, 2008 (fiscal 2008) and March 31, 2007 (fiscal 2007). These documents are available on SEDAR at www.sedar.com and on our Investor webpage at <http://www.bcferries.com/about/investors/index.html>.

Except where indicated, all financial information herein is expressed in Canadian dollars and determined on the basis of Canadian generally accepted accounting principles.

BUSINESS OVERVIEW

British Columbia Ferry Services Inc. is an independent company providing ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world, providing frequent year-round transportation service on 25 routes, supported by 37 vessels and 47 terminals. Our service is an integral part of British Columbia's coastal transportation system and has been designated by the Province of British Columbia (the Province) as an essential service for purposes of the provincial Labour Relations Code. This designation means our services are considered necessary for the protection of the health, safety and welfare of the residents of BC.

We are a versatile company, providing a wide range of ferry services for our customers. In fiscal 2008, we provided more than 187,000 sailings, carrying over 21.7 million passengers and 8.5 million vehicles.

Significant events during or subsequent to fiscal 2008:

New Vessels

(See "Investing in our Capital Assets" below for more detail):

- On March 8, 2008, the first of three new Super C-class vessels, the *Coastal Renaissance*, commenced service on the Departure Bay-Horseshoe Bay route following crew training and familiarization in the operation of this brand new state-of-the-art vessel.

On March 25, 2008, the second Super C-class vessel, the *Coastal Inspiration*, arrived in British Columbia following a 10,000 nautical mile journey from Germany. Crew training and familiarization is currently underway. The vessel is expected to enter service on the Duke Point-Tsawwassen route by the summer of 2008.

On May 9, 2008, the third and final Super C-class vessel, the *Coastal Celebration*, departed Flensburger Schiffbau-Gesellschaft (FSG) shipyard in Germany for its trans-Atlantic journey to BC. The *Coastal Celebration* is expected to be in service on the Swartz Bay-Tsawwassen route by the fall of 2008.

These vessels are the largest double-ended ferries in the world, with each vessel measuring 160 metres in length and having a capacity of 1,650 passengers and crew and approximately 370 vehicles. They feature a diesel-electric propulsion system that is one of the largest and most economical of its kind in the world. These new ships will replace aging vessels which currently provide service on our major routes. The total budget for the three vessels is \$542 million. The project is currently on schedule and under budget.

- In December 2007, the vessel design for the new *Northern Expedition* was completed. The *Northern Expedition*, which is being built by FSG, is expected to replace the 42-year-old *Queen of Prince Rupert*, operating on our northern routes. This 150-metre vessel, which is expected to be in service in the spring of 2009, will have 55 staterooms and will accommodate 130 vehicles and 600 passengers. The total project budget for this vessel is \$200 million. The project is currently on schedule and on budget.
- On January 4, 2008, the hull structure of the *Island Sky*, our new intermediate class ferry, was completed. Steelwork in general is substantially complete and installation and outfitting in preparation for equipment and system testing is underway. The *Island Sky* will allow for the retirement of the 48-year-old *Queen of Tsawwassen*. A \$46 million contract with Vancouver Shipyards constitutes the majority of the total project budget of \$57 million. The shipyard estimates delivery of the vessel by June 27, 2008.

Management's Discussion & Analysis

Major vessel upgrades

(See "Investing in our Capital Assets" below for more detail):

- On June 27, 2007, the 31-year-old *Queen of Alberni*, which usually operates on our Duke Point-Tsawwassen route, returned to service following an extensive \$39 million upgrade to prepare it for another 20 years of service.
- On October 15, 2007, the *Queen of New Westminster*, which usually operates on our Duke Point-Tsawwassen route, began an upgrade to extend the life of the 44-year-old vessel for a further thirteen years of service. The vessel is expected to return to service in the fall of 2008 and be redeployed on our Tsawwassen-Swartz Bay route.

Other items:

- In fiscal 2008, the British Columbia Ferries Commissioner (the Commissioner) released his final second performance term price cap order establishing price cap increases for the four year term beginning April 1, 2008. The price cap increase on April 1, 2008 (starting from a level which includes fuel surcharges in place at March 31, 2008) was 7.3% on the major routes and 4.0% on all other routes. Each subsequent April 1 of the four-year term, the price cap will increase by 2.7% plus 0.49 times the latest reported annual increase in the Consumer Price Index for British Columbia on the major routes and 5.7% plus 0.73 times the latest reported annual increase in the Consumer Price Index for British Columbia on all other routes.
- On January 11, 2008, we closed a \$200 million senior secured bond issue by private placement. The net proceeds were used to repay our credit facility, fund capital expenditures and the debt service reserve related to the bonds and for general corporate purposes. See "Liquidity and Capital Resources" below for more detail.
- In February 2008, coinciding with the conditional acceptance of the *Coastal Inspiration*, we received \$90 million in proceeds under a loan agreement with KfW, a German export credit bank. In May 2008, we received a further \$90 million in proceeds from KfW, coinciding with the conditional acceptance of the *Coastal Celebration*. The net proceeds from these loans were used to partially finance the purchase of these Super C-class vessels. See "Liquidity and Capital Resources" below for more detail.

CORPORATE STRUCTURE

Coastal Ferry Services Contract

We operate ferry services under a regulatory regime as defined by the *Coastal Ferry Act*, and under the terms set out in the Coastal Ferry Services Contract. This 60-year services contract with the Province, which commenced April 1, 2003, stipulates the number of round trips that must be provided for each regulated ferry service route in exchange for specified fees (ferry service fees). In anticipation of the deployment of new vessels on our northern routes, higher ferry service fees were negotiated with the Province for fiscal 2008, the final year of the first performance term of the contract. See "Northern Service" below for more detail. The Coastal Ferry Services Contract also includes fees for the provision of specific social program services delivered on behalf of the Province.

Under the terms of the Coastal Ferry Services Contract, we also receive an annual amount from the Province based on its agreement with the Government of Canada to fulfill the obligation of providing ferry services to coastal British Columbia. The amount of this payment is adjusted annually based on the Vancouver Consumer Price Index.

Economic Regulatory Environment

The office of the Commissioner was created under the *Coastal Ferry Act*, enacted by the Province on April 1, 2003. The Commissioner regulates price caps for designated ferry route groups which, to the end of the first performance term, were specified in the *Coastal Ferry Act*. The Commissioner is also responsible for regulating the reduction of service, discontinuance of routes and certain other matters. The *Coastal Ferry Act* requires the Commissioner to undertake regulation in accordance with several principles, including placing priority on the financial sustainability of ferry operators, encouraging ferry operators to adopt a commercial approach to ferry service delivery and moving over time to a greater reliance on a user pay system.

The Commissioner regulates our tariffs by establishing price caps commencing with the second performance term. Our first performance term ended March 31, 2008, and our second performance term will end March 31, 2012. The core ferry service fees and service levels for the second term have been set and the Commissioner released a final second performance term price cap order. Under this order, the price cap increase (starting from a level which includes fuel surcharges in place at March 31, 2008) was 7.3% on the major routes and 4.0% on all other routes effective April 1, 2008. On each April 1 for the subsequent three years, the price cap will increase by 2.7% plus 0.49 times the latest reported annual increase in the Consumer Price Index (British Columbia) on the major routes and 5.7% plus 0.73 times the Consumer Price Index (British Columbia) on all other routes.

Management's Discussion & Analysis

FINANCIAL AND OPERATIONAL OVERVIEW

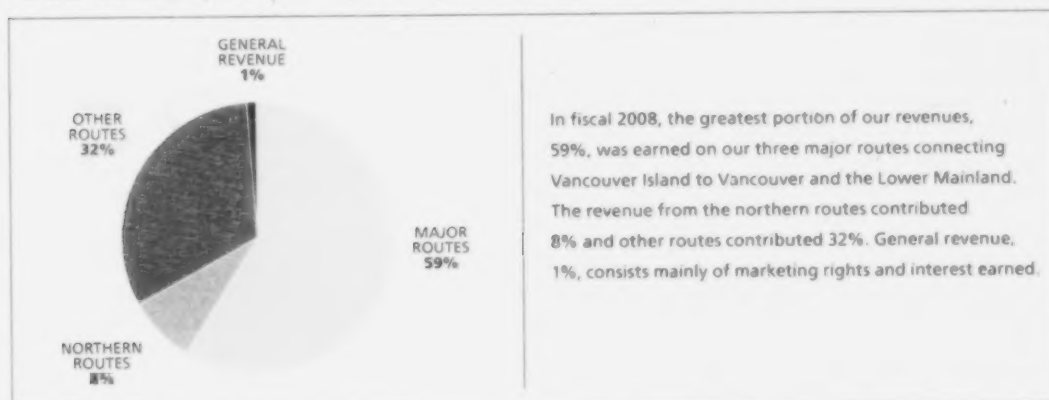
This section provides an overview of our financial and operational performance over the past three fiscal years.

YEAR ENDED MARCH 31 (\$ millions)	2008	2007	2006
Total revenue	640.7	596.3	579.2
% Growth	7.4%	3.0%	2.6%
Expenses	569.6	528.4	504.1
Earnings from operations	71.1	67.9	75.1
Interest and other	34.0	19.1	25.2
Net earnings before extraordinary gain	37.1	48.8	49.9
Extraordinary gain	-	61.3	-
Net earnings and comprehensive income	37.1	110.1	49.9
AS AT MARCH 31	2008	2007	2006
Total assets	1,550.5	1,215.8	833.7
Total long-term financial liabilities	1,059.5	766.3	516.5
Cash dividends	6.0	6.0	6.0

Our earnings from operations in fiscal 2008 were \$3.2 million higher than in fiscal 2007. However net earnings were \$11.7 million lower than net earnings before extraordinary gain in the previous year. Our consolidated net earnings before extraordinary gain in fiscal 2007 were \$1.1 million lower than the previous fiscal year. In fiscal 2007, we recorded an extraordinary gain of \$61.3 million as a result of insurance proceeds resulting from the loss of the *Queen of the North*. See "Northern Service" below for more detail.

Revenue

Our total revenues have increased steadily over the past three fiscal years as shown in the table below.



Total Revenue

YEAR ENDED MARCH 31 (\$ MILLIONS)	2008	2007	2006
Direct Route Revenue			
Vehicle traffic (volume)	8,578,703	8,521,915	8,543,269
Vehicle tariff	240.6	227.3	221.5
Passenger traffic (volume)	21,788,461	21,664,953	21,729,603
Passenger tariff	141.6	135.9	132.1
Social program fees	17.2	16.0	14.7
Catering & on-board	77.8	71.0	66.9
Other revenue	23.7	23.5	21.0
Total Direct Route Revenue	500.9	473.7	456.2
Indirect Route Revenue			
Ferry service fees	105.5	92.4	93.5
Federal-Provincial subsidy	25.8	25.3	24.9
Total Route Revenue	632.2	591.4	574.6
Other general revenue	8.5	4.9	4.6
Total Revenue	640.7	596.3	579.2

Management's Discussion & Analysis

Our largest revenue source is vehicle and passenger tariffs. The annual average tariff rate increase in the first performance term was 2.8% on our three major routes and 4.4% on the remaining routes, as permitted by the *Coastal Ferry Act*. From time to time, we utilize promotional fare incentives designed to stimulate growth in traffic or direct traffic towards our less busy sailings. In calculating the price cap, vehicle and passenger tariffs are combined. The utilization of promotional fare incentives and the effects of being over or under the price cap may cause the average vehicle and passenger tariff rate to be under or over the statutory increase in any one period.

Year to year changes for the past two fiscal years for the major, northern and other routes are discussed separately below.

Year to Year Comparison of Revenues 2008 – 2007

MAJOR ROUTES

FISCAL YEAR ENDED MARCH 31 (\$ THOUSANDS)	2008	2007	INCREASE (DECREASE)	
Direct Route Revenue				
Vehicle traffic (volume)	3,912,269	3,826,459	85,810	2.2%
Vehicle tariff	182,280	171,998	10,282	6.0%
Passenger traffic (volume)	11,304,042	11,146,311	157,731	1.4%
Passenger tariff	104,292	101,300	2,992	3.0%
Social program fees	8,790	8,284	506	6.1%
Catering & on-board	64,154	59,009	5,145	8.7%
Reservation fees	14,035	12,389	1,646	13.3%
Parking	3,110	2,864	246	8.6%
Assured loading	2,662	2,075	587	28.3%
Other revenue	840	4,107	(3,267)	(79.5%)
Total Direct Route Revenue	380,163	362,026	18,137	5.0%
Gross margin - catering & on-board	39,484	35,536	3,948	11.1%

Revenue on the major routes is from customers and related social program fees, and includes no ferry service fees.

Both vehicle traffic and passenger traffic increased over the prior year. The increase in average tariff revenue per vehicle was \$1.64 or 3.6% while the increase in average tariff revenue per passenger was \$0.14 or 1.5%. The increased traffic and higher average fares resulted in a total increase of \$13.3 million in tariff revenue.

Social program fees are reimbursements from the Province of discounts provided on fares for BC seniors, students travelling to and from school, persons with disabilities and persons travelling under the Medical Travel Assistance Program. These fees have increased as a result of higher program usage and higher fares.

All of our vessels that provide service on our major routes have a gift shop and options for food service. The most significant increase in revenues from catering and on-board services was food service, which increased \$3.6 million (\$3.2 million increase in gross margin) as a result of higher spending per passenger and the higher number of passengers carried. Gift shop sales have also increased with the successful introduction of new apparel, gift products and a 2010 Olympic line.

Fees for reservations show a substantial increase as a result of increased usage. Assured loading revenue also shows a marked increase as a result of both increased prices and increased usage.

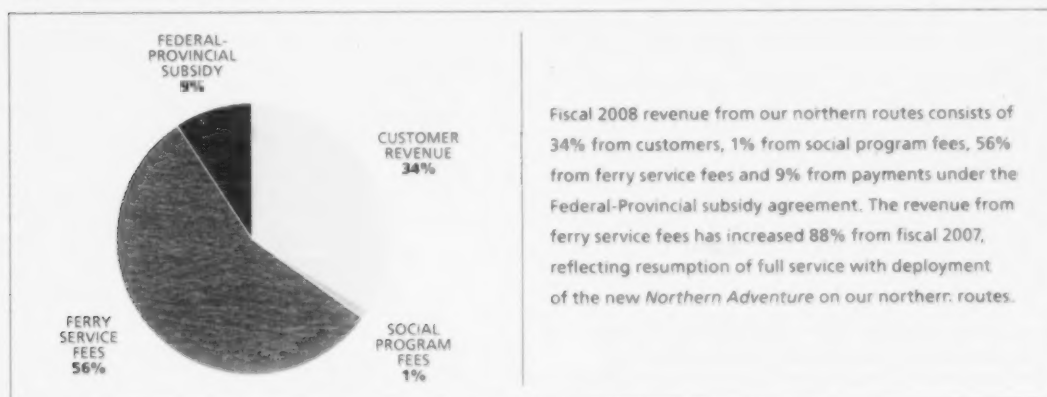
In May 2005, we ceased sales of paper assured loading tickets and implemented the Coast Card, a plastic card with a magnetic strip, similar to a bank card. A \$3.1 million reduction of our deferred revenue liability relating to historical sales of paper tickets was made in fiscal 2007 and is included in other customer revenue in the above table.

Management's Discussion & Analysis

NORTHERN ROUTES

FISCAL YEAR ENDED MARCH 31 (\$ THOUSANDS)	2008	2007	INCREASE (DECREASE)	
Direct Route Revenue				
Vehicle traffic (volume)	33,789	25,854	7,935	30.7%
Vehicle tariff	7,053	5,366	1,687	31.4%
Passenger traffic (volume)	101,751	78,159	23,592	30.2%
Passenger tariff	6,282	4,495	1,787	39.8%
Social program fees	581	380	201	52.9%
Catering & on-board	2,324	1,445	879	60.8%
Reservation fees	80	44	36	81.8%
Stateroom rental	964	359	605	168.5%
Hostling	165	155	10	6.5%
Other revenue	45	29	16	55.2%
Total Direct Route Revenue	17,494	12,273	5,221	42.5%
Indirect Revenue				
Ferry service fees	27,350	14,500	12,850	88.6%
Federal-Provincial subsidy	4,389	4,296	93	2.2%
Total Route Revenue	49,233	31,069	18,164	58.5%
Gross margin - catering & on-board	1,246	710	536	75.5%

Our northern routes consist of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. Traffic levels have steadily increased since the resumption of full service, but have not yet reached the levels experienced during fiscal 2006.



The average tariff revenue per vehicle increased \$1.19 or 0.6%. The average passenger tariff revenue increase was \$4.23 or 7.4%. The increased traffic and higher average tariff resulted in a total tariff revenue increase of \$3.5 million.

We receive ferry service fees for these routes under the Coastal Ferry Services Contract. The increase in fees reflects the negotiated increase resulting from the deployment of the *Northern Adventure*, which commenced operations on March 31, 2007.

Reimbursements from the Province for social program fees increased as a result of resumption of regular service and higher fares.

The increase in catering and on-board revenue resulted from the resumption of regular service and from higher food and gift shop sales per passenger. Stateroom revenue, fees for reservations and hostling¹ have increased primarily as a result of the resumption of regular service.

¹Loading and unloading of commercial trailers that are dropped off for transportation on a ferry route.

Management's Discussion & Analysis

Northern Service

On March 22, 2006, the *Queen of the North*, operating on its regular route from Prince Rupert to Port Hardy, ran aground on Gil Island in Wright Sound and subsequently sank. Our divisional inquiry concluded that human factors were the primary cause of the incident. The Transportation Safety Board (TSB) conclusions, released in March 2008, were consistent with our own.

An emergency environmental plan was implemented in conjunction with external authorities. An extensive monitoring program determined that the spill from the sunken vessel was of short duration and there was minimal effect on the marine ecology of the region. The level of contaminants in edible organisms (i.e. shellfish) was very low and there was no risk for human consumption.

The feasibility and risk of recovering any fuel and lubricants that may remain in the vessel were investigated. The Canadian Coast Guard conclusions were that a significant amount of the fuel and lubricants were released following the incident, a recovery operation would be exploratory at best, and it is probable that there is no recoverable fuel remaining on the vessel. As a result, there is no plan to pursue fuel and lubricant recovery from the incident site.

We purchased oil spill response equipment for the Village of Hartley Bay and have provided oil spill response training to interested Hartley Bay residents. We engaged Hartley Bay residents in the ongoing monitoring of the incident site for leakage and of the adjacent waters for presence and distribution of oil sheen. We equipped them with portable global positioning systems to ensure accuracy of observation and reporting.

Our second stage environmental monitoring program, which started in fall 2007, focuses on testing shellfish. The results of samples collected and tested in September 2007 showed no evidence of contamination from fuel released from the wreck site. This environmental monitoring program will continue with shellfish samples tested before traditional harvesting seasons. We will continue to work with First Nations and other interested parties to ensure appropriate environmental monitoring and response.

We maintain commercial insurance coverage for incidents of this nature. Insurance proceeds, net of deductible, of \$67.9 million were received in May 2006 in settlement of the claim under the hull and machinery policy. We reported an extraordinary gain of \$61.3 million for this event in the first quarter of fiscal 2007. These funds were utilized to partially fund the acquisition of the *Northern Adventure*. We expect that substantially all passenger claims, claims from other parties and costs incurred for environmental containment or cleanup will be paid by our liability insurer.

In March 2007, the *Northern Adventure*, a replacement for the *Queen of the North*, went into service on our northern routes. The two-year-old vessel was purchased in October 2006 and underwent significant modifications to update safety and security equipment, modify the stern to be compatible with our existing berths, upgrade electrical, heating and lighting systems and upgrade customer amenities. This 117-metre vessel has 74 staterooms and accommodates more than 600 passengers and 101 vehicles. With the deployment of this new vessel, the ferry service fees from the Province have increased from the level received prior to the loss of the *Queen of the North* by approximately \$11 million annually, beginning April 1, 2007. This level of ferry service fees reflects the cost of the *Northern Adventure* after receipt of import duties remission and related GST totalling \$13.9 million.

In August 2006, we signed a \$133 million contract with FSG to build the *Northern Expedition*, which is expected to replace the 42-year-old *Queen of Prince Rupert* currently operating on our northern routes. This 150-metre vessel, which is planned to be in service in the spring of 2009, will have 55 staterooms and will accommodate 130 vehicles and 600 passengers. See "Investing in our Capital Assets" below for more detail. With the deployment of this new vessel, the ferry service fees from the Province will increase by approximately \$22 million annually.

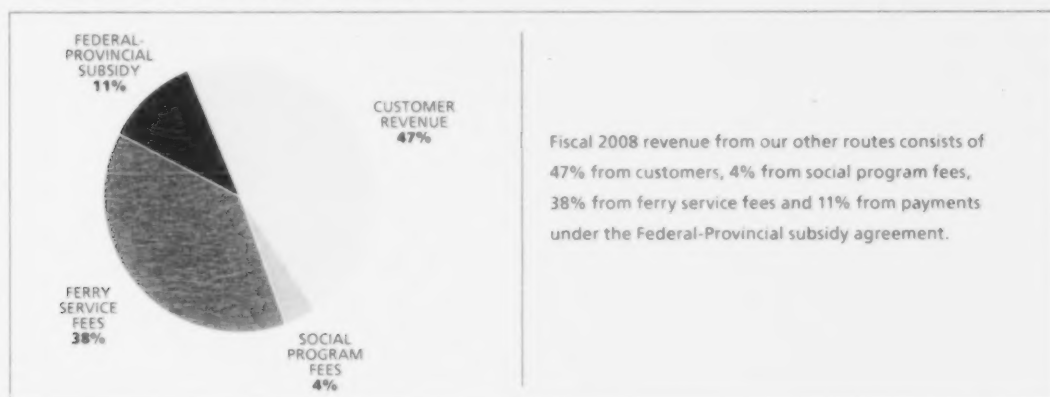
We anticipate a third replacement vessel for the northern service will be acquired and will enter service during our third performance term. Negotiations with the provincial government for increased ferry service fees with respect to this vessel are ongoing.

Management's Discussion & Analysis

OTHER ROUTES

FISCAL YEAR ENDED MARCH 31 (\$ THOUSANDS)	2008	2007	INCREASE (DECREASE)	
Direct Route Revenue				
Vehicle traffic (volume)	4,632,645	4,669,602	(36,957)	(0.8%)
Vehicle tariff	51,319	49,948	1,371	2.7%
Passenger traffic (volume)	10,382,668	10,440,483	(57,815)	(0.6%)
Passenger tariff	31,004	30,122	882	2.9%
Social program fees	7,877	7,302	575	7.9%
Catering & on-board	11,276	10,552	724	6.9%
Reservation fees	1,388	1,213	175	14.4%
Parking	216	205	11	5.4%
Other revenue	145	147	(2)	(1.4%)
Total Direct Route Revenue	103,225	99,489	3,736	3.8%
Indirect Revenue				
Ferry service fees	78,151	77,929	222	0.3%
Federal-Provincial subsidy	21,467	21,013	454	2.2%
Total Route Revenue	202,843	198,431	4,412	2.2%
Gross margin - catering & on-board	7,087	6,533	554	8.5%

Our other routes consist of 19 regulated routes and eight small unregulated routes primarily serving the northern and southern Gulf Islands and the Sunshine Coast. One of the regulated routes and all of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of service on the unregulated routes, which are included in the ferry service fees in the above table.



We experienced a decrease in vehicle and passenger traffic levels on our other routes in fiscal 2008. More than 27% of the vehicle and passenger traffic decrease was as a result of a major refit of the *Mill Bay*, which services our Mill Bay-Brentwood Bay route. Service on this route was suspended for almost two months in the first quarter to allow for the refit. A major refit of the *Mill Bay* is scheduled to occur every four years.

The increase in average tariff revenue per vehicle was \$0.38 or 3.6% while the average passenger tariff revenue increase was \$0.10 or 3.5%. The increased average fares, partially offset by the reduction in traffic levels, resulted in a total tariff revenue increase of \$2.3 million.

Reimbursements from the Province for social program fees increased as a result of higher program usage and higher fares.

During fiscal 2008, the Province agreed to reimburse us a maximum of \$1.6 million for the refit of the 23-year-old *Nicola*, which provides service on our unregulated Prince Rupert-Lax Kw'ala'ams route. At March 31, 2008, we recorded a \$0.5 million reduction of maintenance expense, equal to the refits costs incurred to that date.

Increases in catering and on-board revenue resulted from higher food and gift shop sales per passenger and additional sales from an expanded gift shop on the *Queen of Surrey*, which operates between Horseshoe Bay and Langdale.

Fees for reservations have increased as a result of higher usage. The decrease in other income is mainly a result of additional revenue from charters in the first quarter of the prior year.

Management's Discussion & Analysis

Year to Year Comparison of Revenues 2007 – 2006

MAJOR ROUTES

FISCAL YEAR ENDED MARCH 31 (\$ THOUSANDS)	2007	2006	INCREASE (DECREASE)	
Direct Route Revenue				
Vehicle traffic (volume)	3,826,459	3,790,368	36,091	1.0%
Vehicle tariff	171,998	167,451	4,547	2.7%
Passenger traffic (volume)	11,146,311	11,055,858	90,453	0.8%
Passenger tariff	101,300	97,029	4,271	4.4%
Social program fees	8,284	7,789	495	6.4%
Catering & on-board	59,009	54,516	4,493	8.2%
Reservation fees	12,389	11,581	808	7.0%
Parking	2,864	2,621	243	9.3%
Assured loading	2,075	1,544	531	34.4%
Other revenue	4,107	2,728	1,379	50.5%
Total Direct Route Revenue	362,026	345,259	16,767	4.9%
Gross margin - catering & on-board	35,536	32,415	3,121	9.6%

Vehicle traffic and passenger traffic increased marginally. The increase in average tariff per vehicle was \$0.77 or 1.7% while the increase in average tariff per passenger was \$0.31 or 3.6%. The increased traffic and higher average fares resulted in a total increase of \$8.8 million in tariff revenue.

Social program fees increased as a result of higher program usage and higher fares.

Food sales increased \$3.1 million as a result of higher spending per passenger and the higher number of passengers carried. Gift shop sales increased \$0.9 million with significant improvements in sales of books, clothing and giftware. We achieved higher sales while increasing margins.

Fees for reservations increased as a result of higher usage while parking commissions and premiums from assured loading sales also increased as a result of both increased prices and increased usage.

Other revenue includes a \$3.1 million recognition in fiscal 2007 (\$2.0 million in fiscal 2006) for the reduction of our deferred revenue liability relating to historical sales of paper tickets.

Management's Discussion & Analysis

NORTHERN ROUTES

FISCAL YEAR ENDED MARCH 31 (\$ THOUSANDS)	2007	2006	INCREASE (DECREASE)	
Direct Route Revenue				
Vehicle traffic (volume)	25,854	37,074	(11,220)	(30.3%)
Vehicle tariff	5,366	7,291	(1,925)	(26.4%)
Passenger traffic (volume)	78,159	117,062	(38,903)	(33.2%)
Passenger tariff	4,495	6,768	(2,273)	(33.6%)
Social program fees	380	548	(168)	(30.7%)
Catering & on-board	1,445	2,728	(1,283)	(47.0%)
Reservation fees	44	120	(76)	(63.3%)
Stateroom rental	359	1,018	(659)	(64.7%)
Hostling	155	135	20	14.8%
Other revenue	29	15	14	93.3%
Total Direct Route Revenue	12,273	18,623	(6,350)	(34.1%)
Indirect Revenue				
Ferry service fees	14,500	15,350	(850)	(5.5%)
Federal-Provincial subsidy	4,296	4,227	69	1.6%
Total Route Revenue	31,069	38,200	(7,131)	(18.7%)
Gross margin - catering & on-board	710	1,597	(887)	(55.5%)

The reduction in vehicle and passenger traffic and related revenue in fiscal 2007 resulted from the loss of regular northern service throughout the summer months.

We receive ferry service fees for these routes under the Coastal Ferry Services Contract. The drop in fees reflects the negotiated reduction resulting from the modified summer service we provided as a result of the loss of the *Queen of the North*.

Fees for hostling increased despite the limited northern service during the summer months. Other revenues increased mainly as a result of rental income at Prince Rupert terminal.

Management's Discussion & Analysis

OTHER ROUTES

FISCAL YEAR ENDED MARCH 31 (\$ THOUSANDS)	2007	2006	INCREASE (DECREASE)	
Direct Route Revenue				
Vehicle traffic (volume)	4,669,602	4,715,827	(46,225)	(1.0%)
Vehicle tariff	49,948	46,744	3,204	6.9%
Passenger traffic (volume)	10,440,483	10,556,683	(116,200)	(1.1%)
Passenger tariff	30,122	28,342	1,780	6.3%
Social program fees	7,302	6,337	965	15.2%
Catering & on-board	10,552	9,714	838	8.6%
Reservation fees	1,213	942	271	28.8%
Parking	205	156	49	31.4%
Other revenue	147	150	(3)	(2.0%)
Total Direct Route Revenue	99,489	92,385	7,104	7.7%
Indirect Revenue				
Ferry service fees	77,929	78,199	(270)	(0.3%)
Federal-Provincial subsidy	21,013	20,673	340	1.6%
Total Route Revenue	198,431	191,257	7,174	3.8%
Gross margin - catering & on-board	6,533	5,969	564	9.4%

The increase in average tariff per vehicle was \$0.78 or 7.9% and the average tariff revenue per passenger increased \$0.20 or 7.4%. The increased average tariff, partially offset by the reduction in traffic levels, resulted in a total tariff revenue increase of \$5.0 million.

Reimbursements from the Province for social program fees increased as a result of higher program usage and higher fares.

In fiscal 2007, we experienced higher food sales per passenger and additional sales from an expanded gift shop on the *Queen of Surrey*, which operates between Horseshoe Bay and Langdale.

Fees from reservations increased as a result of higher usage.

Management's Discussion & Analysis

Expenses

Expenses for the past three fiscal years are summarized in the table below.

YEAR ENDED MARCH 31 (\$MILLIONS)	2008	2007	2006
Expenses			
Operations	334.7	309.1	291.7
Maintenance	88.4	84.9	81.1
Administration	49.8	50.6	51.2
Total operations, maintenance & administration	472.9	444.6	424.0
% Increase (decrease)	6.4%	4.9%	(0.3%)
Cost of retail goods sold	29.9	28.3	27.0
Amortization	66.8	55.5	53.1
Total expenses	569.6	528.4	504.1
% Increase	7.8%	4.8%	0.9%
Interest and other			
(Gain) loss on foreign exchange	(0.1)	(0.4)	(0.2)
Interest expense	33.1	19.3	25.1
Loss on disposal of capital assets	1.0	0.2	0.3
Total interest and other	34.0	19.1	25.2

Fuel Deferral and Related Surcharge

In September 2004, the Commissioner issued an order authorizing our use of deferred fuel cost accounts to mitigate the effect of volatility in fuel oil prices on earnings.

Commencing April 1, 2004, the Commissioner established set prices for fuel oil for each of the years until March 31, 2008. At the start of each fiscal year, the set prices increased by the Consumer Price Index (Vancouver). On March 30, 2007, the Commissioner proposed the continued use of inflation-adjusted set prices and deferred fuel cost accounts for the second performance term beginning April 1, 2008.

Differences in fuel costs arising from our actual price paid per litre being higher or lower than the unit set price are charged or credited to the deferred fuel cost accounts.

In order to reduce or eliminate these increasing deferred fuel cost account balances, extraordinary price cap increases were approved by the Commissioner and fuel surcharges were implemented from time to time, beginning in July 2005. On June 1, 2007, adjustments were made to these fuel surcharges on two routes. The deferred fuel cost account balance on the Horseshoe Bay-Langdale route was low enough to allow a reduction in the fuel surcharge. The deferred fuel cost account on the Mill Bay-Brentwood Bay route reflected a surplus position and the fuel surcharge was removed and a rebate was implemented on this route.

Under an agreement reached in March 2007, the Province made a one-time \$7.0 million ferry service fee payment for fiscal 2007, which was applied against the deferred fuel cost accounts in accordance with the agreement. Under an agreement reached during fiscal 2008, the Province paid a further \$1.3 million, which was also applied against the deferred fuel cost accounts in accordance with this agreement.

The Commissioner has considered \$18.5 million of deferred fuel costs in determination of the price caps set for the four years beginning April 1, 2008, and it is expected that recovery will occur over this four year period. The difference between the balance in the deferral accounts at March 31, 2008, and this \$18.5 million will form the opening balances of the fuel deferral accounts for the second performance term.

The Commissioner also set an efficiency target requiring us to reduce fuel consumption by 1% in fiscal 2007 and by an additional 1% in fiscal 2008. At the end of fiscal 2008, we exceeded the 2% cumulative efficiency target.

The balances in our deferred fuel cost accounts totalled \$11.9 million at March 31, 2008 (\$18.8 million at March 31, 2007).

All of the Commissioner's Orders can be viewed at www.bcferrycommission.com.

Management's Discussion & Analysis

Year to Year Comparison of Expenses 2008 – 2007

The \$25.6 million increase in operations expenses reflects:

- \$20.5 million increase in wages and benefits, including:
 - Approximately \$8.0 million in wage rate increases averaging about 4%;
 - \$4.1 million increase in labour on the northern routes with resumption of full service;
 - \$3.5 million increase in benefit costs;
 - \$2.5 million in overtime costs; and
 - \$2.0 million in additional training costs (an increase in operational training from approximately 11,000 to 14,210 person days);
- \$4.6 million increase in fuel expense reflecting the resumption of regular northern service with the addition of the *Northern Adventure*, and an increase in set prices of 1.86% as ordered by the Commissioner; and
- \$3.3 million increase in safety and security costs, including \$2.0 million for the introduction of our SailSafe program — a joint initiative with the BC Ferry & Marine Workers' Union to identify areas and methods for enhancing current safety practices.

These increases were partially offset by:

- \$3.1 million reduction in contracted services relating to the replacement service costs incurred in fiscal 2007 on the northern routes.

The \$3.5 million increase in maintenance costs reflects our continued commitment to safety and the age of our fleet. We completed 26 vessel refits in fiscal 2008 with a further two in progress at March 31, 2008. We have also increased maintenance on our terminals.

Administration expenses decreased \$0.8 million mainly as a result of a reduction in telecommunication costs.

Amortization increased a total of \$11.3 million as a result of additional assets coming into service, including \$5.3 million reflecting the *Northern Adventure* entering service in March 2007.

Interest expenses increased \$13.8 million primarily due to:

- \$12.1 million additional interest relating to our \$250 million bond series issued in March 2007;
- \$2.4 million additional interest relating to our \$200 million bond series issued in January 2008; and
- \$2.6 million reduction in funds received from the Structured Financing Facility Program offered by the Government of Canada. We received \$2.1 million in remaining support for the *Queen of Nanaimo* and *Queen of Surrey* mid-life upgrades during fiscal 2008.

These increases were partially offset by \$3.7 million of additional interest capitalized reflecting our investment in revitalizing our fleet and terminal facilities.

Year to Year Comparison of Expenses 2007 – 2006

The \$17.4 million increase in operations expenses reflects:

- \$8.5 million increase in wages and benefits, including lump sum payments to employees totalling \$3.4 million as a result of the arbitration award; \$1.2 million in additional training costs (an increase in operational training from approximately 8,000 to approximately 11,000 person days); and wage rate increases of \$6.7 million, partially offset by improved labour scheduling practices and as a result of reduced service on northern routes;
- \$3.8 million increase in property tax expense. In fiscal 2006, property tax expense was reduced by \$8.2 million in settlement of terminal property tax assessment appeals for 2004 and 2005;
- \$2.6 million increase reflecting our renewed uniform program; and
- \$1.6 million net increase in marine insurance premiums.

Maintenance expenses, which include expenditures for vessel refit and maintenance as well as terminal maintenance activities, were \$3.8 million higher.

Administration expenses decreased \$0.6 million mainly as a result of a \$2.2 million reduction in severance and restructuring costs, partially offset by a \$1.5 million increase in data communications and telecommunication costs.

Amortization increased a total of \$2.4 million as a result of additional assets coming into service, including \$1.8 million reflecting the *Queen of Surrey* \$37.2 million upgrade;

Interest expenses decreased \$5.8 million due to:

- \$4.0 million of additional interest capitalized reflecting our investment in fleet and terminal revitalization plans;
- \$2.7 million increase in interest rate support recorded under the Structured Financing Facility Program. A total of \$9.9 million in support for the *Queen of Oak Bay*, *Queen of Nanaimo* and *Queen of Surrey* mid-life upgrades was granted of which we reflected \$4.7 million (\$2.0 million in fiscal 2006) as a decrease in bond interest costs and \$0.5 million (\$0.6 million in fiscal 2006) to offset interest costs previously capitalized on the upgrades. The remaining \$2.1 million will be applied against future bond interest costs.

These decreases in interest expense were partially offset by an overall increase in our average level of debt and the effect of interest rates payable on the debt instruments issued and in place as described in the "Liquidity and Capital Resources" section below.

Management's Discussion & Analysis

LIQUIDITY AND CAPITAL RESOURCES

We fund our operations and capital acquisitions with cash flow generated from operations, as well as bank financing and debt issues. We expect operating cash flows to fund approximately one half of the capital expenditures over the next five years, with the balance funded by borrowings.

Long-Term Debt

In May 2004 we entered into a master trust indenture. This indenture established common security and a set of common covenants for the benefit of our lenders. Our financing plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings ranking *pari passu*. We do not currently view common share equity as a potential source of capital and have no present intention of offering common shares to the public or other investors.

Under this indenture we completed two \$250 million public offerings in fiscal 2005:

- 5.74% senior secured bonds, due May 27, 2014; and
- 6.25% senior secured bonds, due October 13, 2034.

The net proceeds were used primarily to repay a portion of our indebtedness to the Province, to fund reserves required in connection with these bonds and for general corporate purposes. Interest on these bonds is payable semi-annually.

In March 2007, we completed a \$250 million, 30-year senior secured bond issue. These private placement bonds bear interest at 5.021%, payable semi-annually. The net proceeds were used primarily to repay our credit facility, fund capital expenditures and the related debt service reserve and for general corporate purposes.

On January 11, 2008, we completed a \$200 million 30-year senior secured bond issue. These private placement bonds bear interest at 5.581%, payable semi-annually. The net proceeds were used to fund capital expenditures and the related debt service reserve and for general corporate purposes.

We also are party to a credit agreement with a syndicate of Canadian banks which is secured under the master trust indenture. Under this agreement, we have available a revolving facility in the amount of \$155 million. In fiscal 2008 we negotiated an amendment that provides us with an option to request a one-year extension annually. In May 2008, we requested and received a one-year extension to this agreement. The facility, maturing May 12, 2013, is available to fund capital expenditures and other general corporate purposes. Currently there are no draws on this facility.

In fiscal 2006 we executed two loan agreements with KfW, a German export credit bank. These agreements are secured under the master trust indenture. The agreements allow us to borrow up to \$90 million per loan, with the net proceeds to be used for partial financing of the purchase of two of

the three Super C-class vessels. In February 2008, to coincide with conditional acceptance of the *Coastal Inspiration*, we received \$90 million in proceeds under the loan agreements. In May 2008, to coincide with conditional acceptance of the *Coastal Celebration*, we received a further \$90 million in proceeds under the loan agreements. These are 12-year amortizing loans, at a fixed interest rate of 4.98%. The agreements defer the principal payments for the first three years to a second tranche on which interest is payable at a floating rate and the principal is due at maturity.

Terminal Leases

We entered into a master agreement with the BC Transportation Financing Authority (BCTFA) effective March 31, 2003, as part of the restructuring of our company. In return for the transfer of ownership interest in all ferry terminals from the former British Columbia Ferry Corporation to the BCTFA at the time of the corporate restructuring, we received recognition of prepayment of rent under terminal leases.

The leases grant us exclusive access and use of ferry terminal properties for a period of 60 years commencing April 1, 2003. The leases are renewable for an additional period of 20 years at a total cost of \$20 per lease if the Coastal Ferry Services Contract is renewed. We must manage, maintain and develop the terminals at our own cost.

Since the original transfer, \$5.1 million of additional lands at Horseshoe Bay and Swartz Bay were added to the existing terminal leases in exchange for highway improvements. During fiscal 2008 we created land by filling in part of the water lot at Departure Bay terminal at a cost of \$1.5 million. It is expected that this land will be added to the land lease once work currently planned for this terminal is completed.

If we fail to meet our obligations under the terminal leases or default under the Coastal Ferry Services Contract, the BCTFA may at its option re-enter and take possession of the ferry terminal properties and at its option terminate the leases. The BCTFA has entered into an acknowledgement agreement with the Bondholders' Trustee, which sets out certain limitations on the use of this option.

In addition to the above, we have entered into a 40-year lease agreement with the Town of Sidney, B.C., to manage an existing ferry terminal owned by the town. This terminal is the western end of a Washington State Ferries' route connecting Vancouver Island with Anacortes, WA.

Other Long-Term Liabilities

Other long-term liabilities consist primarily of accrued post-retirement and post-employment benefits and certain regulatory liabilities.

Management's Discussion & Analysis

Sources & Uses of Cash

Our liquidity needs are met through a variety of sources, including cash generated from operations and borrowings under our credit facility. Our primary uses of funds are operational expenses, capital asset acquisitions and upgrades and interest payments on our long-term debt.

Sources and uses of cash and cash equivalents for fiscal 2008 and 2007 are summarized in the table below.

YEAR ENDED MARCH 31 (\$ MILLIONS)	2008	2007
Net income before extraordinary gain	37.1	48.8
Extraordinary gain		61.3
Items not involving cash:		
Amortization	66.8	55.5
Other non-cash charges	1.6	(1.9)
Regulatory costs deferred	11.6	3.9
Change in operating working capital	6.6	(7.1)
Cash provided by operating activities	123.7	160.5
Cash provided by financing activities	256.6	266.7
Cash used in investing activities	(430.0)	(249.4)
Total (decrease) increase in cash	(49.7)	177.8

In fiscal 2008, cash provided by operating activities includes a decrease in non-cash working capital of \$6.6 million. This decrease was primarily due to:

- \$2.9 million increase in interest payable on the new bond issue and KfW loan;
- \$3.1 million increase in deferred revenue as a result of:
 - \$1.4 million increase in commuter tickets;
 - \$2.7 million increase in assured loading premiums;
 - \$0.2 million increase in reservation liabilities and other deferred revenues; and
 - \$1.2 million reduction in deferred advertising representing the completion of a prepaid sponsorship agreement with Coca-Cola.
- \$3.5 million increase in regulatory liabilities reflecting the increase in tariff revenues collected in excess of the price cap of \$3.4 million for the major routes and \$0.1 million for the northern routes; These funds will be returned to passengers in future periods through discount fare promotions;
- \$5.8 million increase in accrued employee costs;
- \$2.8 million decrease in accounts receivable resulting mainly from decreases of:
 - \$6.1 million in ferry service fees due to the receipt of fees outstanding at March 31, 2007; and
 - \$1.4 million in other receivables.

These decreases were partially offset by increases of:

- \$1.3 million in social program fees recoverable, reflecting higher program usage and two months of receivable (one month at March 31, 2007); and
- \$3.4 million in commercial travel card receivables as a result of a change in payment terms from net 7 to net 30 days.

The working capital decrease was partially offset by:

- \$2.0 million increase in prepaid expenses and inventories;
- \$4.7 million decrease in payables and accrued liabilities relating to refit and maintenance and other operating activities; and
- \$4.8 million increase in current regulatory assets (\$4.6 million of deferred fuel costs and \$0.2 million of second performance term submission costs), representing the amounts that will be amortized and recovered in tariffs during fiscal 2009.

Cash provided by financing activities reflects the \$200 million Series 08-1 bond issuance and the \$90 million loan agreement with KfW, a German export credit bank.

Cash used in investing activities consists mainly of \$427.5 million used to purchase capital assets. The significant capital transactions are described below in "Investing in Our Capital Assets".

Management's Discussion & Analysis

INVESTING IN OUR CAPITAL ASSETS

Capital expenditures in fiscal 2008 totalled \$452.5 million. This level of expenditure reflects significant investments in our fleet, terminals and information systems to increase customer service and operating efficiency. Total capital expenditures were:

(\$ MILLIONS)

New vessels, vessel upgrades and modifications	382.8
Terminal marine structures	26.6
Terminal and building upgrades and equipment	27.9
Computer hardware and software development	15.2
Total Capital Expenditures	452.5

New Vessels, Vessel Upgrades and Modifications

Capital expenditures for new vessels, vessel upgrades and vessel modifications in fiscal 2008 included the following:

(\$ MILLIONS)

New <i>Coastal Renaissance</i> , <i>Coastal Inspiration</i> and <i>Coastal Celebration</i>	319.8
Life extension of the <i>Queen of New Westminster</i>	15.4
Mid-life upgrade to the <i>Queen of Alberni</i>	12.9
New intermediate vessel, the <i>Island Sky</i>	14.0
New northern vessel, the <i>Northern Expedition</i>	8.3
Upgrade and replacement of propulsion and safety equipment on the <i>Quinsam</i> , <i>Quinitsa</i> and <i>Queen of Capilano</i>	6.7
Completion of the <i>Northern Adventure</i> with post-acquisition modifications	5.0
Fire suppression system, improvements to crew safety and upgrades to accommodations for the <i>Howe Sound Queen</i>	3.0
Two-year project to install Voyage Data Recorders and navigational aids and upgrade vessel connectivity	3.0
Refurbishment of car deck on the <i>Powell River Queen</i>	2.3
Sewage treatment upgrade program for 13 vessels	1.9
Passenger accommodation upgrades on the <i>Queen of Burnaby</i>	1.4
Other projects	3.0
Import duties remission and related GST on the purchase of the <i>Northern Adventure</i>	(13.9)
	382.8

To improve fleet safety, we are installing Voyage Data Recorders (VDRs) on all the vessels in the fleet. A VDR is an electronic data collection system that records and securely stores voyage information from various sources, such as navigation equipment, propulsion control systems, radio communications, voice audio and bridge ambient sounds. They have been installed on 23 vessels to date. Our intention is for the entire fleet to have VDRs fitted by early 2009 and for all new construction vessels to be fitted during construction.

Management's Discussion & Analysis

Major Vessel Upgrades

The *Queen of New Westminster*, which usually operates on our Duke Point-Tsawwassen route, is currently undergoing a project to extend the life of the 44-year-old vessel for a further thirteen years of service. This \$55 million project will include significant upgrades for structural fire protection; a new marine evacuation system; major electrical upgrades; boiler, auxiliary generator and emergency generator renewal; and propulsion controls upgrade. The *Queen of New Westminster* is expected to return to service in the fall of 2008 and be redeployed on our Tsawwassen-Swartz Bay route.

The *Queen of Alberni*, which usually operates on our Duke Point-Tsawwassen route, returned to service on June 27, 2007, following an extensive \$39 million upgrade. The 31-year-old vessel underwent significant upgrades to prepare for another 20 years of service. The upgrades included safety and mechanical improvements as well as improved and expanded passenger amenities. The *Queen of Alberni* is the fifth, and final, C-class vessel to undergo such a major mid-life upgrade. Similar upgrades have been completed on the *Queen of Coquitlam*, *Queen of Cowichan*, *Queen of Surrey* and *Queen of Oak Bay*.

Coastal Renaissance, Coastal Inspiration and Coastal Celebration

In September 2004 we entered into contracts with FSG to build three new Super C-class vessels that are the largest double-ended vessels in the world. Each vessel measures 160 metres in length and has a capacity of 1,650 passengers and crew and approximately 370 vehicles. These new vessels feature a diesel-electric propulsion system that is one of the largest and most economical of its kind in the world. These Super C-class vessels are replacing aging vessels that have been providing service on our major routes.

The contracts with FSG are design-build and fixed price, totalling \$325 million. The contracts provide us with substantial guarantees related to delivery dates, performance criteria, cost certainty and quality of construction. These contracts, together with import duties and taxes of approximately \$112 million, form the majority of the total project budget of \$542 million. We are currently seeking a remission of the import duties and related GST of approximately \$86 million, but are uncertain as to the outcome of this application. Foreign currency based payments in this project have been hedged in Canadian dollars to manage the foreign exchange risk. The project for these three new state-of-the-art vessels is expected to be completed on schedule and within budget.

Construction of the *Coastal Renaissance* started in August 2006 and the vessel was launched in Germany in April 2007. It commenced service on the Departure Bay-Horseshoe Bay route on March 8, 2008, following crew training and familiarization in the operation of this new vessel.

Construction of the *Coastal Inspiration* commenced in November 2006 and the vessel was launched in August 2007. On March 25, 2008, it arrived in British Columbia. Crew training and familiarization is currently underway. The vessel is expected to enter service on the Duke Point-Tsawwassen route by the summer of 2008.

Construction of the *Coastal Celebration* began in April 2007 and the vessel was launched in December 2007. It departed Germany on May 9, 2008, for its trans-Atlantic journey to British Columbia. The vessel is expected to commence service on the Swartz Bay-Tsawwassen route in the fall of 2008.

These three new vessels each feature four unique photographic images promoting the 2010 Olympic and Paralympic Winter Games and the natural beauty of British Columbia. The *Coastal Celebration's* journey home included a promotional stop in London to raise awareness for the Games and to promote British Columbia as a tourist destination.

Northern Expedition

We signed a \$133 million contract with FSG to build a new vessel which is expected to replace the 42-year-old *Queen of Prince Rupert* currently operating on our northern routes. The import duties and taxes on this contract will total approximately \$43 million. We will be seeking a remission of the import duties and related GST of approximately \$35 million, but are uncertain as to the outcome of our application. This design-build, fixed price contract (the majority of the total project budget of \$200 million) provides us with substantial guarantees for delivery dates, performance criteria, cost certainty and quality of construction. Foreign currency based payments in this project have been hedged in Canadian dollars to manage the foreign exchange risk. The vessel design was completed in December 2007 and approximately 60% of the superstructure modules have been assembled. This 150-metre vessel, which is expected to be in service in the spring of 2009, will have 55 staterooms and will accommodate 130 vehicles and 600 passengers.

Northern Adventure

Our application for import duties remission relating to the purchase of the *Northern Adventure* was approved and \$13.1 million was received from the federal government in September 2007. The total of \$13.9 million, including related GST, has been applied as a reduction of the cost of the vessel. In accordance with the Coastal Ferry Services Contract, the receipt of the import duties remission has resulted in a reduction in provincial northern ferry service fees.

Island Sky

On January 4, 2008, the hull structure of the *Island Sky*, our new intermediate class ferry, was completed. Steelwork in general is substantially complete and erection is underway at Vancouver Shipyards in North Vancouver. The \$45.5 million contract with Vancouver Shipyards constitutes the majority of the total project budget of \$57 million. The new intermediate vessel will allow for the retirement of the 48-year-old *Queen of Tsawwassen*. The new vessel will measure 102 metres in length and have a capacity of approximately 600 passengers and 125 vehicles. It will feature a new state-of-the-art lifesaving system as well as a variety of amenities, including a lounge and snack bar for passengers. Although the contract provides for delivery of this vessel by April 7, 2008, we have been informed by the shipyard that their revised estimate of the delivery date is June 27, 2008.

Management's Discussion & Analysis

Terminal Marine Structures

We continued to reinvest in our terminal infrastructure in fiscal 2008. We made significant upgrades to many of our terminals and made preparations for the arrival of the new Super C-class vessels. Over the next five years, we plan to invest approximately \$250 million in our terminals for building and marine structure upgrades.

Capital expenditures on terminal marine structures for fiscal 2008 included the following:

(\$ MILLIONS)		
TERMINAL	DESCRIPTION	
Departure Bay	Berth upgrades to accommodate Super C-class vessels	5.0
Horseshoe Bay	Berth upgrades to accommodate Super C-class vessels	4.6
Skidegate	New pontoon, ramp, ramp abutment and two dolphins	4.0
Prince Rupert	New pontoon, ramp, ramp abutment and dolphin	2.1
Bear Cove	New pontoon, ramp and ramp abutment	1.0
Village Bay	Replacement of wingwall structures	1.6
Duke Point	Berth upgrades to accommodate Super C-class vessels	1.5
Otter Bay	Refurbish two floating leads and replace two others	1.4
Departure Bay	Electrical upgrades	1.4
Various	Other projects	4.0
		26.6

To replace aging berths and to accommodate the Super C-class vessels, modifications of marine structures at three berths at Departure Bay terminal and two berths at Horseshoe Bay terminal are complete. The modifications to the berth at Duke Point are currently in progress. These berth refurbishments and upgrades include new trestles, dolphins² and catwalks.

Terminal and Building Upgrades and Equipment

Besides upgrades to terminal marine structures, many other terminal upgrades are underway to provide better service to our customers and improve operational efficiencies. The most significant activity this fiscal year has been at two of our major terminals, Departure Bay and Swartz Bay. Capital expenditures on terminal and building upgrades and equipment included the following:

(\$ MILLIONS)	
Departure Bay terminal	17.8
Swartz Bay terminal	6.9
Alert Bay terminal	1.0
Security upgrades	0.9
Other terminal projects	1.3
	27.9

At Departure Bay terminal, the holding compound, pick-up and drop-off area, and the short term parking are being expanded. A new retail building, ticket building, waiting room and washrooms are being built. The foot passenger walkway will be improved and the intersection realigned. In fiscal 2008, we spent \$17.8 million of this \$40.7 million project.

At Swartz Bay terminal, the holding compound and pre-ticket area are being expanded, new ticket booths built, the radar maintenance building relocated and the exit re-aligned. In fiscal 2008, \$6.5 million of the \$6.9 million spent on the terminal related to this \$9.2 million project.

At Alert Bay terminal, the holding compound was expanded, a pick-up/drop-off lane and passenger sidewalk created, and the waiting shelter replaced. We completed this \$2.1 million project in August 2007.

At nine terminals, mainly serving our major and northern routes, we have begun a multi-year project to upgrade our security. This project primarily involves fencing, gating, lighting, access controls and closed circuit television as well as upgrades to foot passenger ticketing areas and baggage screening.

² A cluster of pilings firmly fixed to the sea bed and used to assist vessels during docking.

Management's Discussion & Analysis

Information Technology

Capital expenditures in information technology include computer hardware and software development to improve operational data capture and reporting, time collection and database security.

We launched a new card-based electronic payment method in March 2008. This electronic swipe card can be redeemed for travel (and eventually, other products and services) instead of using cash, credit cards or prepaid paper tickets. The new card will also offer customers loss protection, which is not available with prepaid paper tickets. The assured loading product which has been available on the Coast Card (first introduced in May 2005) has also been added to this new card.

We implemented a new system to capture and report operational statistics in a more timely and accurate manner. This system utilizes an integrated data management solution to standardize traffic data collection and capture processes.

Other ongoing projects include enhanced reporting initiatives, better external and internal communications, real-time credit card authorization, automated ticketing, and replacement of obsolete technology and security projects. These projects focus on obtaining efficiencies, improving safety and security and providing better service to our customers.

FOURTH QUARTER RESULTS

This section provides an overview of our financial performance for the three months ended March 31, 2008, compared to the three months ended March 31, 2007.

The fourth quarter reflects a seasonal reduction in traffic levels which we utilize to perform upgrades and major maintenance and refit programs as well as to undertake mandatory inspections on the majority of our vessels.

THREE MONTHS ENDED MARCH 31 (\$ MILLIONS)	2008	2007	VARIANCE	
			\$	%
Total revenue	124.2	119.0	5.2	4.4%
Expenses	144.2	146.7	2.5	1.7%
Loss from operations	(20.0)	(27.7)	7.7	27.8%
Interest and other	10.5	5.5	(5.0)	(90.9%)
Net loss	(30.5)	(33.2)	2.7	8.1%

Revenue

Our total revenues have increased as shown in the following table.

THREE MONTHS ENDED MARCH 31 (\$ MILLIONS)	2008	2007	INCREASE (DECREASE)	
			\$	%
Direct Route Revenue				
Vehicle traffic (volume)	1,726,422	1,707,063	19,359	1.1%
Vehicle tariff	44.9	43.7	1.2	2.7%
Passenger traffic (volume)	4,133,676	4,034,986	98,690	2.4%
Passenger tariff	24.5	23.7	0.8	3.4%
Social program fees	3.7	3.7	0.0	0.0%
Catering & on-board	14.3	13.0	1.3	10.0%
Other revenue	4.2	6.3	(2.1)	(33.3%)
Total Direct Route Revenue	91.6	90.4	1.2	1.3%
Indirect Route Revenue				
Ferry services fees	24.0	20.2	3.8	18.8%
Federal-Provincial subsidy	6.4	6.3	0.1	1.6%
Total Route Revenue	122.0	116.9	5.1	4.4%
Other general revenue	2.2	2.1	0.1	4.8%
Total Revenue	124.2	119.0	5.2	4.4%

Management's Discussion & Analysis

Higher vehicle and passenger traffic volume and higher average tariff rates have resulted in higher tariff revenue of \$2.0 million.

The majority of the increase in catering and on-board revenue during the quarter was on our major routes.

Ferry service fees are higher, reflecting resumption of full service with deployment of the new *Northern Adventure* on our northern routes.

Other direct revenue is lower due to the recognition in fiscal 2007 revenue of a \$3.1 million write down of the deferred revenue liability relating to historical sales of paper assured loading tickets.

Expenses

Expenses are shown in the following table.

THREE MONTHS ENDED MARCH 31 (\$ MILLIONS)	2008	2007	(INCREASE) DECREASE	
			\$	%
Operations	84.0	77.6	(6.4)	(8.2%)
Maintenance	22.8	31.8	9.0	28.3%
Administration	13.6	16.7	3.1	18.6%
Cost of retail goods sold	5.9	5.4	(0.5)	(9.3%)
Amortization	17.9	15.2	(2.7)	(17.8%)
	144.2	146.7	2.5	1.7%
Interest & other	10.5	5.5	(5.0)	(90.9%)
Total expense	154.7	152.2	(2.5)	(1.6%)

The increase in operations costs reflects our new safety program, additional training costs and wages and benefit increases partially offset by a reduction in uniform costs.

The decrease in maintenance costs reflects the additional refit and maintenance activities that were brought forward from fiscal 2008 into the last quarter of fiscal 2007.

Lower administration costs reflect lower telecommunication costs and the capitalization of computer hardware leases in fiscal 2008.

Amortization increases reflect the vessel, terminal and other projects that came into service during fiscal 2008.

Interest expense increases are primarily a result of our \$250 million bond series issued in March 2007, our \$200 million bond series issued in January 2008, and the receipt in the last quarter of fiscal 2007 of interest rate support under the Government of Canada's Structured Financing Facility Program.

Management's Discussion & Analysis

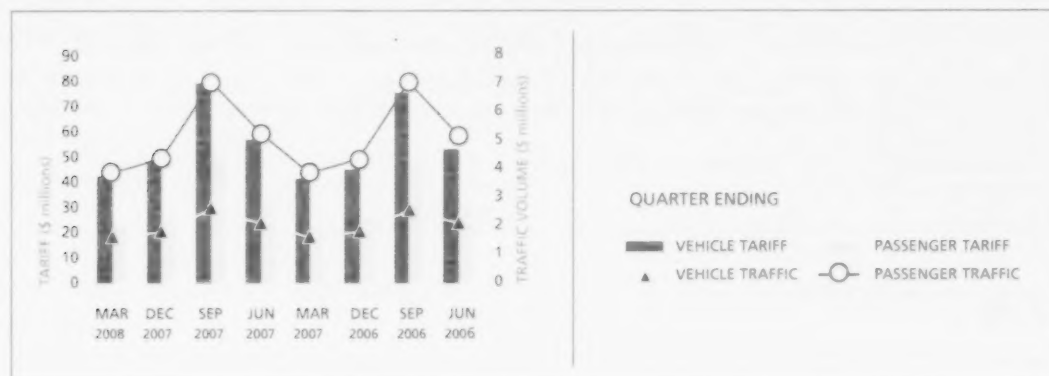
SUMMARY OF QUARTERLY RESULTS

The table below compares earnings by quarter for the most recent eight quarters.

QUARTER ENDED (UNAUDITED) (\$ MILLIONS)	MAR 08	DEC 07	SEP 07	JUN 07	MAR 07	DEC 06	SEP 06	JUN 06
Total revenue	124.2	136.5	220.2	159.8	119.0	128.4	202.7	146.4
(Loss) earnings from operations	(20.0)	(0.4)	69.4	22.1	(27.7)	2.5	73.0	20.3
Net (loss) earnings before extraordinary gain	(30.5)	(7.8)	61.0	14.4	(33.2)	(1.8)	68.9	14.9
Extraordinary gain	0.0	0.0	0.0	0.0	0.0	0.0	0.0	61.3
Net (loss) earnings and comprehensive income	(30.5)	(7.8)	61.0	14.4	(33.2)	(1.8)	68.9	76.2

Quarterly results are affected by the seasonality of leisure travel patterns. The second quarter, covering the summer period, experiences the highest traffic levels and the highest net earnings. The third and fourth quarters reflect a seasonal downturn in traffic. We utilize these periods to perform upgrades and major maintenance and refit programs, as well as to undertake mandatory inspections on the majority of our vessels.

The following graph demonstrates the seasonality of our revenue and shows the relationship of traffic volume and tariff revenue over the most recent eight quarters.



Management's Discussion & Analysis

OUTLOOK

Safety and Environmental Protection

The safety of the public and our employees and the protection of the environment are our highest priorities. Part of our safety plan was to increase, during fiscal 2008, the level of annual operational training we conduct from approximately 11,000 to 14,200 person days. We completed the year having conducted 14,210 days of training.

In October 2007, we officially launched SailSafe — a joint initiative with the BC Ferry & Marine Workers' Union that builds on our current safety practices and reflects our common commitment to safety as an essential part of our business and our daily work. This initiative will involve employees in identifying areas and methods for enhancing current safety practices.

We are proactive in ensuring environmental regulations are met or exceeded and in developing strategies to help us become an industry leader in environmental management. We have programs in place to protect the environment and reduce greenhouse gas emissions and are introducing new initiatives to further mitigate our environmental impact. Besides recycling beverage containers, cardboard and newsprint, we are also:

- using biodegradable hydraulic oils;
- using low sulphur fuel in all vessels;
- replacing chemical products with more environmentally friendly solutions;
- recycling used cooking oil, spent fluorescent tubes and batteries;
- reviewing environmental performance of selected contractors;
- replacing gasoline powered terminal vehicles with electric vehicles; and
- replacing gasoline powered baggage vans with propane powered tugger units.

We have a fuel reduction strategy that is designed to reduce fuel consumption and emissions on our vessels. To date, we have implemented a wide variety of fuel saving measures ranging from operating our vessels more efficiently to installing new, more fuel-efficient engines on some of our vessels and fuel monitoring systems on others and designing and building our new vessels to meet or exceed current environmental standards.

Asset Renewal Program

Although we have one of the largest fleets in the world, the average age of our assets is currently among the oldest of major ferry operators worldwide. To address this, we are continuing with our fleet and asset renewal program. In March 2007, we added the *Northern Adventure* and the *Kuper* to our fleet and in March 2008, the first Super C-class vessel, the *Coastal Renaissance*, commenced service. Over the five-year period ending March 2013, we will bring six new vessels into service with an aggregate cost of \$845 million, of which \$405 million has been expended to March 31, 2008. These vessels include:

- two additional Super C-class vessels, the *Coastal Inspiration* and *Coastal Celebration*;
- two northern vessels, the *Northern Expedition* and *Northern Discovery*;
- an intermediate class ferry, the *Island Sky*; and
- a minor vessel to replace the *Tenaka*.

Upgrading and replacing a large share of our fleet through new vessel acquisitions and our revitalization program will also assist in maintaining operational reliability.

We continue to reinvest our retained earnings into our asset renewal program. As the capital projects are completed and come into service, amortization and financing costs will increase. We expect this will cause a decrease in our earnings in the near term.

Traffic

Ferry traffic levels are affected by a number of factors, including transportation costs, the value of the Canadian dollar, weather, global security, levels of tourism, disposable personal income, the local economy, demographics and population growth. We experienced an increase in both total passenger and total vehicle traffic in fiscal 2008, following two years of moderate decreases. Over the past five years they are both trending upwards. In fiscal 2008, we experienced increased traffic levels on our major and northern routes and an overall decrease in traffic levels on our other routes.

During fiscal 2007, traffic levels were negatively affected by the loss of capacity on our northern routes, an unprecedented number of severe wind and snow storms in November and December 2006, and the implementation of fuel surcharges. With the introduction of the *Northern Adventure* into service in March 2007, we anticipated that traffic on our northern routes would return to former levels. Since the resumption of full service, traffic levels have not yet reached the levels experienced in fiscal 2006, but they are steadily increasing. Over the next few years, we anticipate modest traffic volume increases on all our routes.

Management's Discussion & Analysis

VEHICLE TRAFFIC BY FISCAL YEAR (THOUSANDS)

	2008	2007	2006	2005	2004
Major routes	3,912.3	3,826.5	3,790.4	3,808.8	3,688.1
Other routes	4,632.6	4,669.6	4,715.8	4,711.5	4,567.1
Northern routes	33.8	25.8	37.1	37.1	37.0
Total	8,578.7	8,521.9	8,543.3	8,557.4	8,292.2
Annual % increase (decrease)	0.7%	(0.3%)	(0.2%)	3.2%	(0.4%)
Five year % increase	3.5%				

PASSENGER TRAFFIC BY FISCAL YEAR (THOUSANDS)

	2008	2007	2006	2005	2004
Major routes	11,304.0	11,146.3	11,055.9	11,222.3	10,824.7
Other routes	10,382.7	10,440.5	10,556.7	10,687.0	10,425.7
Northern routes	101.8	78.2	117.0	117.2	117.0
Total	21,788.5	21,665.0	21,729.6	22,026.5	21,367.4
Annual % increase (decrease)	0.6%	(0.3%)	(1.3%)	3.1%	(1.2%)
Five year % increase	2.0%				

Fuel Costs

Fuel is a major cost of our operations. It has increased significantly over the past few years and there is uncertainty of future pricing. We use deferred fuel cost accounts to mitigate the effect of volatility in fuel oil prices on earnings. Differences in fuel costs arising from our actual price paid per litre being higher or lower than the unit set price included in base tariffs are charged or credited to the deferred fuel cost accounts.

In performance term one, to reduce the increasing balances of the deferred fuel cost accounts, the Commissioner approved extraordinary price cap increases to allow for fuel surcharges which were implemented from time to time, beginning in July 2005. In performance term two, there is an automatic mechanism in place to allow price cap increases to provide for implementation of fuel surcharges. Based on the current forecast of fuel pricing, we expect to implement fuel surcharges in the fall of 2008. (See "Fuel Price Risk" below for more detail)

Market Growth

Notwithstanding the pressure on traffic volumes, we see opportunities for growth.

In March 2007, we established Pacific Marine Ventures Inc. (PMV) as a wholly owned subsidiary to pursue strategic business opportunities, including terminal management opportunities outside our routes. In September 2007, PMV assumed management of the Sidney International Ferry terminal. Under a 40-year lease, PMV is managing and developing the towns ferry terminal with a focus on developing new business opportunities. Washington State Ferries continues to be the primary user of the facility with its service to Anacortes, Washington. At the same time, PMV is pursuing other management services opportunities.

To increase our profile in the Lower Mainland, expand our new market reach and further develop travel and tourism partnerships, in February 2008 we signed a lease to develop a 2,700 sq ft travel centre in the new Fairmont Pacific Rim property currently under construction in downtown Vancouver. We anticipate our travel centre will open in late 2009.

During fiscal 2008, we realized a 12.5% increase in commercial traffic revenue compared to the previous year. To increase our capacity in the commercial sector, we have assigned one new Super C-class vessel to each major route between the Lower Mainland and Vancouver Island. As a result, the *Coastal Inspiration* will join the recently upgraded *Queen of Alberni* on our Duke Point-Tsawwassen route – the route most frequently used by commercial truckers. Additionally, our commercial sales team is continuing to actively pursue new business and is implementing new integrated sales solutions and enhanced services for our commercial customers.

Regulation

Transport Canada regulates safety on our vessels by authority of the *Canada Shipping Act*. On July 1, 2007, the *Canada Shipping Act, 2001* came into effect. This is the principal legislation governing the activities of Canadian vessels in all waters and of all vessels in Canadian waters. The impact of the revised regulations on the useful life of some of our vessels and/or the requirement for vessel upgrades is not well defined. There may also be an impact on required crew levels, training and certification which could increase our operating costs. We are addressing the changing regulations through our planning processes and asset renewal initiatives as information becomes available. As always, the safety of our customers and employees remains our highest priority.

In 2001, the federal government enacted the *Marine Transportation Security Act*. Initially the legislation and the associated regulations were limited to international ports and vessels. We have received a copy of the proposed amendments to the existing regulations and the intent is to include domestic ferries and facilities within the *Marine Transportation Security Act* framework. If enacted, we will be required to satisfy a specific level of security on our vessels and at our terminals servicing our major and certain other routes. Considerable security investments will be required in the areas of fencing, cameras, closed circuit TV, better access controls and screening. We have developed a corporate security strategy and completed location-specific

Management's Discussion & Analysis

security plans on the major routes and northern routes that are required to comply with the regulations. Through the Marine Security Contribution Program, we are eligible for reimbursement of \$3.8 million of federal funding under our first application to help offset the costs of perimeter security, access control measures and training. We anticipate making future applications to offset costs of security upgrades to vessels and terminals.

Our tariffs are regulated and our service levels are monitored by the Commissioner. The Commissioner regulates our tariffs by establishing price caps over a performance term. Our first performance term ended March 31, 2008 and our second performance term ends March 31, 2012. The core ferry service fees and service levels for the second term have been set and the Commissioner released a final second performance term price cap order. Under this order, the price cap increase (starting from a level which includes fuel surcharges in place at March 31, 2008) was 7.3% on the major routes and 4.0% on all other routes effective April 1, 2008. On each subsequent April 1 of the four-year term, the price cap will increase by 2.7% plus 0.49 times the latest reported annual increase in the Consumer Price Index (British Columbia) on the major routes and 5.7% plus 0.73 times the Consumer Price Index (British Columbia) on all other routes.

Competition

New competitors have emerged in both the passenger-only market and the commercial traffic market in the past few years. To date, passenger-only competitors have not been successful at sustaining operations.

We are witnessing increased competition in the commercial sector, where three companies, including ourselves, are now vying for differing segments of the freight transport business between Vancouver Island and the Lower Mainland. To maintain and potentially increase our market share, we plan on improving operational efficiency and customer service on our three major routes. We will accomplish this by increasing capacity for both commercial and passenger vehicle traffic with the assignment of one Super C-class vessel to each major route and improving traffic efficiency at the Departure Bay and Horseshoe Bay terminals. We are also investigating other new service offerings.

In an effort to reduce costs on our regulated routes and as mandated by the Coastal Ferry Act, we are exploring opportunities to have ferry services provided by additional or alternative service providers. While we maintain responsibility for the long-term delivery of ferry services, we are required to test the market to determine if another operator, under contract to BC Ferries, could provide safe, reliable and high quality service that is more cost-effective.

A Request for Proposal (RFP) process is currently under way for the Brentwood Bay-Mill Bay route. We expect to make a decision on whether to proceed with an alternative service provider on this route by the end of June 2008.

During fiscal 2008, we worked with a potential alternative service provider, who approached us on an unsolicited basis, regarding a possible pilot project for the Buckley Bay-Denman Island and Hornby Island-Denman Island routes. The arrangement to consider the viability of the pilot project on an exclusive basis with this company has been terminated.

We are presently preparing to initiate a Request for Expression of Interest (RFEOI) for alternative service delivery of the Campbell River-Quadra Island, Quadra Island-Cortes Island, and Port McNeill-Sointula-Alert Bay routes. We expect to issue the RFEOI in the summer of 2008 and will determine the next steps of the procurement process based on the responses we receive. Additionally, we expect to issue an RFP regarding the operation of our four routes north of Port Hardy; however, the timing of this request is uncertain.

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FINANCIAL INSTRUMENTS

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment.

Derivatives

We hedge our exposure to fluctuations in fuel prices and foreign currency exchange rates through the use of derivative instruments. The table below provides details of the carrying value and fair value of the derivative instruments at March 31, 2008 and 2007.

	MARCH 31, 2008				MARCH 31, 2007	
	NUMBER OF SWAPS	TERM TO MATURITY (YEARS)	CARRYING VALUE Asset (Liability) (\$ millions)	FAIR VALUE	CARRYING VALUE Asset (Liability) (\$ millions)	FAIR VALUE
Commodity Fixed Price Swaps	9	Up to .75	1.8	1.8	0.7	0.7
Foreign Exchange Forward Transactions (Super C-class vessels)	14	Up to .25	0.5	0.5	0.0	(18.7)
Foreign Exchange Forward Transactions (Northern Expedition)	5	Up to 1.0	15.9	15.9	(2.8)	8.6

The commodity derivatives fair value reflects only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. These fair values reflect the estimated amounts that we would receive or pay should the derivative contracts be terminated at the stated dates. Any gains or losses related to fuel commodity swaps are charged to our deferred fuel cost accounts. At March 31, 2008, we have recorded a receivable of \$1.8 million as the estimated gain to terminate the contracts as at this date.

The foreign exchange derivative fair value reflects only the value of the foreign exchange derivatives and not the offsetting change in value of the underlying future purchase of currency. These fair values reflect the estimated amounts we would receive or pay to terminate the derivative contracts at the stated dates. We de-designated all previously designated hedges for hedge accounting on June 30, 2007. With the adoption of the new Canadian Institute of Chartered Accountants (CICA) Handbook sections on financial instruments, all derivatives are recorded at mark to market on our balance sheet. Any gains or losses related to these foreign exchange forward contracts are charged to our regulatory accounts.

We are exposed to credit risk in the event of non-performance by counterparties to derivative instruments. Because we deal with high credit quality institutions in accordance with established credit approval practices, we believe it to be unlikely that any counterparties will fail to meet their obligations.

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RISK MANAGEMENT

We continue to employ a variety of commonly accepted methodologies to identify, assess and mitigate risks. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business. We view the following risks as most important:

Safety

The safety of the public and our employees is our highest priority. In fiscal 2007, we commissioned former BC Auditor General, George L. Morfitt, to conduct an independent review of our safety policies, procedures and practices. We also plan to conduct a similar comprehensive operational safety review at a minimum of every five years as part of our ongoing commitment to ensuring the safety of our passengers and employees.

Some of the recommendations in the Morfitt report were put into practice in fiscal 2007 while others have been incorporated into our new safety program, SailSafe, which was launched in October 2007. SailSafe is a joint initiative with the BC Ferry & Marine Workers' Union that builds on our current safety practices and reflects our common commitment to safety as an essential part of our business and our daily work. This initiative will involve employees in identifying areas and methods for enhancing current safety practices and ensuring that safety is our first priority each and every day.

Asset Risk

We operate in a capital-intensive industry and have an aging infrastructure that requires substantial investment. We plan to spend approximately \$900 million in capital expenditures over the next five years, with approximately 50% related to new vessel acquisitions. Our plan includes the replacement of six of our oldest vessels before the end of fiscal 2013. At this time, the *Queen of Vancouver*, *Queen of Saanich*, *Queen of Esquimalt* and the *Queen of Tsawwassen* are available for sale.

At March 31, 2008, we have total long-term debt of \$1.03 billion. Future indebtedness is subject to certain limitations. The level of indebtedness could increase our vulnerability to general adverse economic and industry conditions, and limit our flexibility in planning for, or reacting to, changes in business. Also, there can be no guarantee that we will have access to sufficient resources or will be able to maintain our fleet by extending the economic life of existing vessels through major refurbishment.

Regulatory/Performance Risk

Our operations are subject to a wide variety of national and local laws and regulations, all of which may change at any time. There is the potential that the introduction of new safety or other regulations, including new taxes, or the interpretation of existing regulations, may impose a new, unexpected and significant cost burden. (See "OUTLOOK - Regulation" above for a discussion of the potential impacts of the *Canada Shipping Act, 2001* and the *Marine Transportation Security Act*). There can be no guarantee that regulatory changes in the future will not have an adverse effect on us.

We cannot predict how the British Columbia Ferries Commissioner's interpretation, administration and enforcement of the Coastal Ferry Act will change over time. Such changes may impact our ability to sustain or increase profitability.

There is a risk that we will default under the Coastal Ferry Services Contract or the Terminal Leases. The consequences of such default could include, among other things, an adjustment to ferry service fees from the Province or the forced sale of our vessels to the Province for net book value and termination of the Terminal Leases.

Traffic Level and Tariff Revenue Risk

Future vehicle and passenger traffic on our vessels will be affected by, among other things, population levels and economic conditions in British Columbia and also by tariff rates. No assurance can be given as to the level of traffic on our system and the tariff revenue that will result.

We believe that demographics are changing on many of the small coastal islands that we serve. Individuals appear to be purchasing properties on these islands as vacation rather than primary residences. These individuals visit their island properties less frequently. This appears to have caused a decrease in the number of commuters on these routes. There is a risk that a continuation of this trend may result in a more significant decline in traffic.

There is a risk that over the long term a general decline in travel (or a reduction in the growth rate) may occur as a result of increasing tariffs, potentially compounded with fuel surcharges. Demand elasticity could change as tariffs increase, thereby resulting in a negative impact on tariff revenue. To date, the tariff increases we have implemented have not caused an obvious decrease in demand.

We believe that a significant number of our customers travel for leisure purposes. Traffic on our vessels may decline, or fail to increase as expected, if world or local events have a negative effect on tourism or other leisure travel.

Fuel Price Risk

Fuel costs have increased significantly over the past few years and have reached unprecedented levels. There is uncertainty of the cost of fuel in the future. We have the ability to pass through increases in fuel costs to our customers with surcharges. Based on current market pricing, we expect to implement fuel surcharges in the fall of 2008.

High levels of fuel pricing could translate into significant fuel surcharges and result in unprecedented total tariff levels. Although our traffic levels have not shown any significant effect from the higher tariff costs, there is uncertainty about the impact on future ferry traffic levels if fuel surcharges and therefore total tariff costs rise significantly. There is a risk of a decline in ferry traffic levels as a result of increasing customer costs resulting from the implementation of fuel surcharges.

The price of motor vehicle fuel has also increased significantly, causing the general cost of travel to increase. Continuing high motor vehicle fuel costs may affect decisions on discretionary travel. There is uncertainty about the impact on ferry traffic levels as a result of the increasing cost of motor vehicle fuel and there is a risk that customers may alter travel plans as a result.

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Environmental Risk

Our operations are subject to various environmental laws and regulations dealing with the transportation, storage, presence, use, disposal and handling of hazardous materials and hazardous wastes, discharge of storm water and vessel fuel delivery.

The Kyoto Protocol aims to reduce emissions of greenhouse gases. The provincial government has made a commitment to reduce greenhouse gas emissions by 33% by the year 2020, based on emissions in 2007. While the reduction targets have not yet been set, the transportation industry has been identified as a sector that will have emission limits. If we were to be involved in an environmental accident or be found in material violation of applicable law and regulations, we could be responsible for material clean-up costs, property damage, and fines or other penalties, any of which could have a material adverse effect. Although we believe we maintain adequate environmental insurance, there can be no guarantee that the insurance coverage will be sufficient to cover all such losses.

Security Risk

Deliberate, malicious acts could cause death, injury or property damage. The occurrence of a major incident could also negatively affect the propensity for the public to travel, reducing our ferry traffic levels. The effect could vary depending on whether it was a domestic or international incident and whether or not it was in the marine transportation industry. It could also lead to a substantial increase in insurance and security costs. Any resulting reduction in tariff revenues and/or increases in costs could have a material adverse impact on our business, results from operations and financial condition.

Accident/Casualty Loss

The occurrence of a major accident or mishap could have a material adverse effect on our business prospects, financial condition or results of operations, and could result in a default under the Coastal Ferry Services Contract unless such accident or mishap qualified as an event of force majeure. We have a sound conventional insurance program designed to mitigate the financial impact of serious incidents. There can be no guarantee, however, that the insurance coverage will be sufficient to cover all such accidents or disasters.

Human Resources

The majority of our employees are members of the BC Ferry & Marine Workers' Union. On March 8, 2007, a final award was released by arbitrator Vince Ready, building on the October 2004 interim award. This is expected to provide us with labour stability until the end of the term on October 31, 2012 and provide a unique and innovative dispute resolution process to facilitate future collective bargaining. However, there can be no guarantee that other labour disturbances will not occur and have a material adverse effect on our operations.

We are also dependent on maintaining our ability to attract, train and retain employees with the requisite skill and capabilities to operate in the marine industry. Shortages of critical skills are emerging in most areas in which we operate.

Income Tax Risk

We received an advance income tax ruling from Canada Revenue Agency (CRA) that, provided the facts and other statements set out therein are accurate, we are a "Tax Exempt Corporation" described in paragraph 149(1)(d.1) of the *Income Tax Act*. This ruling is subject to a proposed amendment to subsection 149(1.3) of the *Income Tax Act* announced by the Department of Finance on December 20, 2002, the essential elements of which are now included in Bill C-10, which received second reading in the Senate on December 4, 2007. We have received a non-binding opinion from CRA that subsection 149(1.3), if amended as proposed on December 20, 2002, will not cause us to cease to be a Tax Exempt Corporation. There can be no assurance that subsection 149(1.3) of the *Income Tax Act* will be amended as proposed, or that we are and will continue to be a Tax Exempt Corporation.

Treaty Negotiations: Aboriginal Rights and Title

Canadian courts have recognized that aboriginal peoples may possess rights at law in respect of land used or occupied by their ancestors where treaties have not been concluded to deal with these rights and where treaties between aboriginal peoples and the Crown set out express rights. These rights may vary from limited rights of use for traditional purposes to a right of aboriginal title. Aboriginal groups have claimed substantial portions of land in British Columbia over which they assert aboriginal title or in which they have a traditional interest.

Under evolving jurisprudence, Canadian governments have a duty to consult and accommodate aboriginal peoples where Crown approvals or licences are required in respect of existing or new terminal facilities or operations at such facilities and could affect or impact aboriginal interests.

Under the master agreement, the Province retains its liability, to the extent any exists, for the acts and omissions of the Province that occurred prior to our possession of the ferry terminal properties leased under the Terminal Leases and will reimburse us for any damages we suffer as a result.

In addition, the Province will reimburse us for damages suffered if there is a final court decision or a treaty settlement that recognizes or confers upon aboriginal peoples a proprietary or other interest in the ferry terminal properties which right or interest interferes with our quiet enjoyment of the ferry terminal properties as set out in the Terminal Leases.

Management's Discussion & Analysis

ACCOUNTING PRACTICES

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with Canadian generally accepted accounting principles.

Our significant accounting policies are contained in note 1 to our consolidated financial statements. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under different conditions or using different assumptions. These estimates and assumptions are subject to change as new events occur, as more experience is acquired, as additional information is obtained and as the general operating environment changes.

We believe the following are the most critical accounting policies and estimates that we have used in the preparation of our financial statements.

Workers' Compensation Claims Liability

Our financial statements include an estimate of residual liability for workers' compensation claims arising from the Workers' Compensation Board (WCB) deposit class coverage system, in which our predecessor entity participated on or prior to March 31, 2003.

The WCB provided our predecessor company with an actuarial valuation of the unfinalized claims remaining to be paid that relate to incidents on or prior to March 31, 2003. This estimate totalled \$9.3 million at March 31, 2003 and is drawn down as claims are paid out. In fiscal 2007 we received an actuarial valuation estimating that the unfinalized claims remaining to be paid at March 31, 2006, totalled \$4.7 million. As a result we reduced the unfinalized claims liability and decreased expenses by \$1.8 million during fiscal 2007. The remaining balance at March 31, 2008, of \$2.7 million (\$3.6 million at March 31, 2007) is included in accrued employee future benefits in our financial statements.

Public Service Pension Plan

Our employees are members of the Public Service Pension Plan (the Plan), a defined benefit and multiemployer pension plan. In April 2003, we were converted from a Crown corporation into an independent company incorporated under the provincial *Company Act*, and we now validly exist under the *Business Corporations Act* (British Columbia). In February 2004, our company and the union representing our employees jointly submitted a formal application for all our employees and our company to remain within the Plan. In March 2004, the Public Service Pension Board of Trustees agreed to the proposal.

The Plan is exempt from the requirements under the provincial *Pension Benefits Standards Act* to use the "solvency" method in conjunction with the "going concern" method for valuation purposes. As such, the Plan is currently valued solely by the going concern method. The most recent valuation of the total Plan, as at March 31, 2005, indicated an unfunded liability in the Basic Account of \$767 million.

Effective April 1, 2006, the Public Service Pension Board of Trustees increased contribution rates for plan members and employers by 1.88% each, effectively eliminating the unfunded actuarial liability.

Retirement Bonus Liability

We sponsor a plan that provides a post-retirement benefit for eligible long service employees. The valuation of this plan is estimated based on complex actuarial calculations using several assumptions. These assumptions are determined by management with significant input from our actuary. The valuation of the obligation depends on such assumptions as discount rate, projected salary increases, retirement age and termination rates. An actuarial valuation of the plan at March 31, 2007, was obtained and the accrued benefit obligation estimated at \$13.4 million. The liability included in accrued employee future benefits in our financial statements at March 31, 2008, was \$10.5 million (\$10.2 million at March 31, 2007).

We have adopted the corridor method of recognizing actuarial gains and losses. Any gains and losses in excess of 10% of the obligation balance will be amortized over the average remaining service period of employees expected to receive benefits under this plan.

Rate Regulation

We follow generally accepted accounting principles which, as we are a regulated entity, may differ from those otherwise expected in non-regulated businesses. These differences occur when the regulator issues orders and generally involve the timing of revenue and expense recognition. The principles we follow ensure that the actions of the regulator, which create assets and liabilities, have been reflected in the financial statements.

The accounting for these items is based on an expectation of the future actions of the regulator. As of March 31, 2008, we have four regulatory assets or liabilities:

- Deferred fuel costs: the difference between amounts allowed by the regulator in operating expense and those actually incurred with recovery expected through future tariffs or surcharges;
- Performance term submission costs: costs for incremental contracted services relating to our second performance term submission which our regulator has approved for recovery over our second performance term that begins April 1, 2008;
- Tariffs in excess of price caps: the amount by which average annual tariffs collected at a specific date exceed established price caps set under the terms of the *Coastal Ferry Act*. The excess amounts collected will be returned to customers through future tariffs;
- Hedge gains – vessel construction contracts: unrealized gains on financial derivative instruments relating to the construction of the *Northern Expedition*, the *Coastal Inspiration* and the *Coastal Celebration*. These gains will ultimately form part of the capital cost of the new vessels.

If the regulator's future actions are different from our expectations, the timing and amount of the recovery of deferred costs could be substantially different from that reflected in our financial statements.

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AMORTIZATION EXPENSE

Our capital assets, including assets under capital leases, are amortized on a straight-line basis at varying rates. Amortization rates require the use of estimates of the useful lives of the assets and of salvage to be realized upon asset retirement.

We periodically review asset lives in conjunction with our longer term asset deployment, replacement and upgrade strategies. When we determine that asset lives do not reflect the expected remaining period of benefit, we make prospective changes to the remaining period over which they are amortized. There are a number of uncertainties inherent in estimating our asset lives and changes in these assumptions could result in material adjustments to our financial statements.

As disclosed in note 1 to our financial statements, we review and evaluate our long-lived assets for impairment when events or changes in circumstances indicate that the related amounts may not be recoverable.

HEDGING RELATIONSHIPS

In April 2005, the Canadian Institute of Chartered Accountants (CICA) issued Handbook Section 3865, replacing Accounting Guideline 13 which we had adopted on April 1, 2004.

This standard addresses the identification, designation, documentation and effectiveness of hedging transactions for the purpose of applying hedge accounting. It also identifies situations where hedge accounting is to be discontinued. Under this guideline, we are required to prepare formal documentation for each individual derivative in order to apply hedge accounting for positions hedged with derivatives.

During fiscal 2005, we elected to apply hedge accounting on the currency derivatives relating to the three new Super C-class vessels. During fiscal 2007 we elected to apply hedge accounting on the currency derivatives for the new *Northern Expedition*. On June 30, 2007, we de-designated all previously designated hedges for hedge accounting. With the adoption effective April 1, 2007, of the new CICA Handbook sections on financial instruments, all currency and fuel commodity derivatives are recorded at mark to market on our balance sheet.

ASSET RETIREMENT OBLIGATIONS

On April 1, 2004, we adopted the CICA new standard for recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. Under the new standard the fair value of a liability for an asset retirement obligation must be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value is added to the carrying amount of the associated asset, which is then expensed over the asset's estimated useful life. The liability is accreted over the estimated useful life of the asset through charges to expenses.

As we are not aware of any future liabilities associated with the retirement of our assets, the adoption of this policy does not result in the recording of an asset retirement liability and therefore our financial statements have not been impacted by this standard. In addition, as our operations are regulated, there is a reasonable expectation that any significant asset retirement costs would be recoverable through future tariffs.

Adoption of New Accounting Standards

Effective April 1, 2007, we adopted the CICA Handbook Section 1530, *Comprehensive Income*, CICA Handbook Section 3251, *Equity*, CICA Handbook Section 3855, *Financial Instruments - Recognition and Measurement*, CICA Handbook Section 3861, *Financial Instruments - Disclosure and Presentation*, and CICA Handbook Section 3865, *Hedges*. These new Handbook sections provide comprehensive requirements for the recognition and measurement of financial instruments, as well as standards on when and how hedge accounting may be applied. Handbook Section 1530 also establishes standards for reporting and displaying comprehensive income. Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with generally accepted accounting principles.

Under these new standards, all financial instruments are classified into one of the following five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are included on the consolidated balance sheet and are initially measured at fair value. Subsequent measurement and recognition of changes in fair value of financial instruments depends on their initial classification. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet. Loans and receivables, investments held-to-maturity and other financial liabilities are measured at amortized cost.

The standards require derivative instruments to be recorded as either assets or liabilities measured at their fair value unless exempted from derivative treatment as a normal purchase and sale. Certain derivatives embedded in other contracts must also be measured at fair value. All changes in the fair value of derivatives are recognized in earnings unless specific hedge criteria are met, which requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting.

Management's Discussion & Analysis

The adoption of these standards has the following effect on the consolidated financial statements for fiscal 2008:

- (a) Recognition of foreign currency forward contracts as derivative assets and liabilities in the consolidated financial statements;
- (b) Restatement of opening retained earnings at April 1, 2007, to recognize the prior years' earnings effect of accounting for long-term debt using the effective interest rate method; and
- (c) Reclassification of deferred financing costs to long-term debt.

We also de-designated all previously designated hedges on June 30, 2007 under Section 3865 - Hedges. All of these hedges, which were entered into to provide greater certainty of the cost of new vessel acquisitions denominated in foreign currency, were effective at the time of de-designation. All hedges are recorded at fair value with unrealized gains and losses recorded to the regulatory asset or liability accounts on the balance sheet.

We have no embedded derivatives that meet the requirements of Section 3855 which would require that they be separated from host contracts and valued separately at fair value.

We have not recognized any adjustments through other comprehensive income for fiscal 2008.

The adoption of these sections is done prospectively without restatement of the consolidated financial statements of prior periods. As at April 1, 2007, the impact on the consolidated financial statements of recording foreign currency forward contracts as derivative assets and liabilities, measuring the long-term debt using the effective interest rate method and reclassifying the deferred financing costs directly attributable to the issuance of the long-term debt, is summarized in the table below:

(\$ MILLIONS)	APRIL 1, 2007	MARCH 31, 2007	NET IMPACT
Derivative assets	8.6	-	8.6
Other assets - deferred financing costs	1.0	9.6	(8.6)
Derivative liabilities	18.6	2.8	15.8
Long-term debt	740.6	749.6	(9.0)
Retained earnings	204.0	203.5	0.5

In the table above, the remaining balance of deferred financing costs at April 1, 2007, represents costs incurred for long-term debt arranged for but not yet issued.

Future Accounting Changes

The following CICA Handbook Sections will be effective for us beginning April 1, 2008:

- Section 1535, *Capital Disclosures* establishes standards for disclosing information about our capital and how it is managed. The standard requires disclosure of our objectives, policies and processes for managing capital, the quantitative data about what we regard as capital, whether we have complied with any capital requirements and if we have not complied, the consequences of such non-compliance. We do not expect application of this section to have a significant impact on our consolidated financial statements.
- Section 3031, *Inventory*, replacing Section 3030 provides guidance on the determination of inventory cost, subsequent recognition as expense, and write-downs to net realizable value. We do not expect application of this section to have a significant impact on our consolidated financial statements.
- Section 3862, *Financial Instruments - Disclosure* requires disclosures, by class of financial instrument that enable users to evaluate the significance of financial instruments on financial position and performance, including disclosures about fair value. In addition, disclosure is required of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity

risk, and market risk. The quantitative disclosures must also include a sensitivity analysis for each type of market risk to which an entity is exposed, showing how net earnings and other comprehensive income would have been affected by reasonably possible changes in the relevant risk variable. We do not expect application of this section to have a significant impact on our consolidated financial statements.

- Section 3863, *Financial Instruments - Presentation* carries forward existing requirements on presentation of financial instruments. We do not expect application of this section to have any impact on our consolidated financial statements.

We have not yet adopted the following CICA Handbook Sections which will be effective for us beginning April 1, 2009:

- Section 3064, *Goodwill and Intangible Assets* does not substantively change the requirement pertaining to goodwill. The changes in requirements pertaining to intangible assets primarily relate to recognition criteria for purchased and internally developed assets which will result in few intangible assets being recognized on the balance sheet. We are assessing the impact of this section on our consolidated financial statements.

Management's Discussion & Analysis

- To be applied prospectively, are amendments to Sections 1100 *Generally Accepted Accounting Principles*, 3465 *Income Taxes* and Accounting Guideline AcG-19 *Disclosures by Entities Subject to Rate Regulation*. With release of these amendments, a temporary exemption that permitted assets and liabilities arising from rate regulation to be recognized and measured on a basis other than in accordance with the primary sources of generally accepted accounting principles will be removed. In addition, accounting recommendations have been amended to require recognition of future income tax liabilities and assets as well as offsetting regulatory assets and liabilities at entities subject to rate regulation. We do not expect application of these amendments to have any impact on our consolidated financial statements. We will continue to monitor any additional implications on our financial reporting related to accounting for rate regulated operations.

In 2006, the Canadian Accounting Standards Board (AcSB) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian generally accepted accounting principles with International Financial Reporting Standards (IFRS) over an expected five year transitional period. During March 2008, the AcSB confirmed the transition dates for conversion to IFRS. Our transition date for the conversion to IFRS is April 1, 2011 and will require the restatement for comparative purposes of amounts reported by us for the year ended March 31, 2011. While we have begun assessing the adoption of IFRS, the financial reporting impact of the transition cannot be reasonably estimated at this time.

CORPORATE STRUCTURE AND GOVERNANCE

Our Board of Directors and management consider good corporate governance to be central to the effective, efficient and prudent operation of the Company. Both management and the Board have monitored and, where appropriate, responded to regulatory developments aimed at improving corporate governance practices, increasing corporate accountability and enhancing the transparency of public company disclosure and will continue to monitor the developments in corporate governance practices.

In 2005, National Instrument 58-101 *Disclosure of Corporate Governance Practices* (the "Instrument") and a related National Policy 58-201 *Corporate Governance Guidelines* (the "Guidelines") issued by the Canadian Securities Administrators came into effect. The Guidelines and Instrument require reporting issuers to disclose annually their approach to corporate governance with reference to specific matters. See Schedule A for the disclosure in accordance with this Instrument.

FORWARD LOOKING STATEMENTS

This management's discussion and analysis contains certain "forward looking statements". These statements relate to future events or future performance and reflect management's expectations regarding our growth, results of operations, performance, business prospects and opportunities and industry performance and trends. They reflect management's current internal projections, expectations or beliefs and are based on information currently available to management. Some of the market conditions and factors that have been considered in formulating the assumptions upon which forward looking statements are based include traffic, rising Canadian Dollar relative to US Dollar, fuel costs and the fuel reduction program, construction costs, the state of the local economy, demographics, duty remission, GST reduction, and the requirements of the Coastal Ferry Services Contract.

In some cases, forward looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other comparable terminology. A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors including, but not limited to, the risks and uncertainties associated with safety and security, traffic volume and tariff revenue risk, asset risk, accident risk, tax risk, environmental risk, regulatory risk, labour disruption risk, risk of default under material contracts and aboriginal land claims.

Actual results may differ materially from any forward looking statement. Although management believes that the forward looking statements contained in this management's discussion and analysis are based upon reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward looking statements. These forward looking statements are made as of the date of this management's discussion and analysis, and British Columbia Ferry Services Inc. assumes no obligation to update or revise them to reflect new events or circumstances.

Management's Discussion & Analysis

SCHEDULE A

Corporate Structure and Governance

Board of Directors

The Board has assumed responsibility for the stewardship of British Columbia Ferry Services Inc. (BCF or the Company) by overseeing the conduct of the business, supervising Management, which is responsible for the day-to-day conduct of the business, and endeavouring to ensure that all major issues affecting the business and affairs of the Company are given proper consideration.

At March 31, 2008, the Board was comprised of the following directors:

Chair:	Elizabeth J. Harrison Q.C.
Vice Chair:	Thomas W. Harris
Members:	Douglas E. Allen, Mark L. Cullen, Sandy M. Fulton, David L. Hahn, Donald P. Hayes, John R. Henderson, Doreen J. Hewitt, Brian G. Kenning, Gordon R. Larkin, Maureen V. Macarenko, Robert W. McCaskill, A. Daniel Miller, Wayne H. Stollen and, Graham M. Wilson

Effective April 1, 2008, Sandy M. Fulton, John R. Henderson, Doreen J. Hewitt and Robert W. McCaskill ceased to be directors and Christopher C. Gardner became a director.

The Board Governance Manual articulates the governance framework under which the Board fulfills its stewardship responsibilities. The manual assembles in one document the essential elements for providing an appropriate level of governance for the organization. It includes, among other things, terms of reference for the Board, chair, directors, committees and committee chairs, and serves as a practical guide for the Board and management in fulfilling their respective duties and responsibilities. The governance framework is a product and responsibility of the Board.

The Board is committed to the principles of independence and accountability. The Board has adopted policies and practices that ensure it has the capacity, independent of management, to fulfill the Board's responsibilities, make objective assessments of management, and assess the merits of management initiatives. The Governance & Nominating Committee has an ongoing responsibility to ensure that the governance structures and processes continue to enable the Board to function independently.

The Board and management recognize that there is a regular need for the Board to meet without management in attendance. It is general practice to conduct a portion of every Board meeting with only independent directors present.

The Board and its committees each have the authority to retain any outside advisor, at the Company's expense, that it determines to be necessary to permit it to carry out its duties.

The recruitment of directors is undertaken with the objective of ensuring the Board is composed of a majority of strong, qualified, independent directors. The Board supports the concept that the role of the board chair is separate from that of the President & CEO and that the board chair should be an independent director. These principles are reflected in the Board Governance Manual.

The Board has adopted a definition of an independent director for members of the Audit & Finance Committee consistent with the definition of independence in Multilateral Instrument 52-110. This definition, with some modification that is consistent with Multilateral Instrument 52-110, also applies to determining the independence of other members of the Board.

The Board is responsible for determining whether directors are independent pursuant to the definition of independence adopted by the Board. To do this, the Board requires members to disclose their relationships with the Company and its subsidiaries. These disclosures are reviewed by the General Counsel, the Corporate Secretary, and the Chair of the Board. Any director who is deemed independent, and whose circumstances change such that he or she might be considered to no longer be an independent director, is required to promptly advise the Board of the change in circumstances. Directors are required annually to attest to their independence in writing.

Mr. David L. Hahn, President & CEO, is the only director who is a member of management of the Company. By virtue of his being a member of management, Mr. Hahn is not independent. The other directors of the Company, including the Chair of the Board, have been determined by the Board to be independent pursuant to the definition of independence adopted by the Board.

Directorships

The following were directors of a reporting issuer (or the equivalent) in Canada or a foreign jurisdiction, other than BCF:

Elizabeth J. Harrison, Q.C.:	Director, Unilens Vision Inc.
Graham M. Wilson:	Director, ITRON Inc. Director, Naikun Wind Energy Group Trustee, Hardwoods Income Trust Director, Daylight Energy Ltd.
Brian G. Kenning:	Director, MacDonald Dettwiler & Associates Inc. Director, Royal Oak Ventures

Orientation and Continuing Education

The Company has a variety of orientation and education programs in place for directors. These programs are aimed at increasing the directors' familiarity with the operation of the Company and its governance practices.

All new directors are provided with the opportunity to participate in an orientation program. The orientation program is tailored to the individual director's needs and areas of interest. The program generally involves a full day session, held prior to a new director attending his/her first BCF Board meeting, during which the new director is briefed by members of senior management and receives written information about the business and operations of BCF and Board governance practices, including the duties and obligations of directors. A copy of the Board Governance Manual is made available to all directors. This manual provides a comprehensive overview of the roles and responsibilities of the Board, its committees, and the contributions expected by each director. The Board recognizes the importance of ongoing director education and the need for each director to take personal responsibility for this process.

Management's Discussion & Analysis

Responsibility for ensuring that orientation and ongoing education are provided to directors rests with the Chair of the Board. The Governance & Nominating Committee has responsibility for reviewing the orientation and education programs to ensure they are effective and meet the needs of directors.

Ethical Business Conduct

The Board of Directors approved and adopted a Code of Business Conduct and Ethics (Code) on November 10, 2004. Notice of adoption of the Code as Company policy was communicated to the Company's personnel by intra-Company information bulletin widely distributed throughout the Company. In addition, the Code has been posted on the Company's Intranet website for Company personnel, and on the Company's Internet site. The Code was filed on SEDAR on March 1, 2006. The Board has also adopted a Corporate Disclosure and Securities Trading Policy, which is also posted on the Company's Intranet and Internet sites.

As part of the Company's disclosure controls process, in conjunction with quarter-end financial reporting, appropriate managers are required to make representations regarding compliance with the Code and the Corporate Disclosure and Securities Trading Policy.

As part of the communication process for the reporting of questionable accounting and auditing matters, a secure telephone line and a secure e-mail address, each monitored by the executive director of Internal Audit, have been established and this has been communicated to Company employees by intra-Company information bulletin. The contact particulars are also posted with the Code on the Company's intranet site.

The Board, through the Audit & Finance Committee, monitors compliance with the Code through review of compliance reports received quarterly from management, the external auditors, and the internal auditors.

Directors and officers review the Code and acknowledge their support and understanding of the policy by signing an annual disclosure statement.

The Code requires that directors and officers disclose potential conflicts of interest at the time of their appointment and immediately upon a situation of a conflict of interest or potential conflict of interest arising. Such disclosures are communicated to and reviewed by the General Counsel, the Corporate Secretary, and the Chair of the Board.

Nomination of Directors

The B.C. Ferry Authority (the BCFA), through its Board of Directors, selects the Board of Directors of BCF. While not a requirement, it is current practice that the directors of BCFA are also directors of BCF.

The Articles of Incorporation of BCF permit a total of 20 directors of BCF, hence directors may be appointed to the Board of BCF in addition to those who are also directors of BCFA. It is viewed as desirable to maintain consistency between the two Boards so that the interests of BCFA and BCF are properly aligned. However, the ability to appoint additional directors to the Board of BCF gives flexibility in ensuring adequate skill sets and experience are available within the members of the Board of BCF.

In 2007, the BCF Board of Directors established a Nominating Committee, composed entirely of independent directors, to lead the nomination processes for BCF. Effective April 1, 2008, the responsibilities for matters related to director nomination and corporate governance were combined in a single committee, the Governance & Nominating Committee, and the Nominating Committee ceased to exist.

The Governance & Nominating Committee is composed entirely of directors who are independent, pursuant to the definition of independence adopted by the Board of BCF. The Chair of the Board of BCF is the Chair of the Governance & Nominating Committee.

Each year, the skill sets and experience of the incumbents and any retiring directors of BCF are reviewed by the Governance & Nominating Committee in the context of the skills and experience profile adopted by the BCF Board and the ongoing governance needs of BCF. Any gaps are identified. Potential conflicts of interest and other extenuating circumstances are also identified.

The skill sets and experience of the candidates for the BCFA Board, that are put forward by the nominating entities and the Province, are reviewed by the Governance & Nominating Committee to ascertain if there will be any gaps in the skill sets and experience of the Board of BCF, assuming BCFA directors also become BCF directors. If gaps are identified, the Governance & Nominating Committee, in consultation with the President & CEO, seeks out suitable candidates for nomination as directors of BCF to fill such gaps.

The Governance & Nominating Committee makes recommendations to the BCF Board of Directors on suitable candidates for appointment to the BCF Board. These recommendations take into account the talents of the existing BCF Board, and the talents of all nominees (including BCFA Board nominees and appointees who may become BCF Board members, if applicable), taking the skills and experience profile established for BCF directors into account.

The BCF Board makes its decision on prospective directors and forwards its recommendations to the BCFA Board. The BCFA Board then determines the directors of BCF and causes BCFA, as the sole holder of the single voting share of BCF, to appoint such directors to the Board of BCF.

Compensation

The compensation of directors is reviewed by the Board on a bi-annual basis. Prior to April 1, 2008, the responsibility for reviewing and making recommendations to the Board regarding the compensation of directors rested with the Governance & Human Resources Committee. Effective April 1, 2008, the Board changed the structure of the Board Committees and responsibility for matters relating to director compensation was assigned to the Governance & Nominating Committee and the Governance & Human Resources Committee ceased to exist.

The Governance & Nominating Committee operates under terms of reference adopted by the Board.

The Committee engages an external compensation advisor to research and provide independent advice on the level and types of compensation for directors. In making its recommendations to the Board, the Committee takes into account the types of compensation and the amounts paid by other comparable companies.

Management's Discussion & Analysis

Board Committees

The Board reviews the structure of the Board Committees on an annual basis and, as noted above, made changes to the structure effective April 1, 2008. These changes are summarized below.

BOARD COMMITTEE STRUCTURE

AT MARCH 31, 2008

- Audit & Finance
- Safety, Health, Environment & Security
- Governance & Human Resources
- Nominating

EFFECTIVE APRIL 1, 2008

- Audit & Finance
- Safety, Health, Environment & Security
- Governance & Nominating
- Human Resources & Compensation

Audit & Finance Committee (at March 31, 2008):

Chair: Graham M. Wilson

Members: Douglas E. Allen; Thomas W. Harris;
John R. Henderson, Robert W. McCaskill

Effective April 1, 2008, Donald P. Hayes and Brian G. Kenning became members of the Committee and Thomas W. Harris ceased to be a member. Also effective April 1, 2008, Robert W. McCaskill and John R. Henderson ceased to be directors and members of the committee.

The Audit & Finance Committee (Committee) is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities. The Committee has the mandate to:

- review the financial reports and other financial information provided by the Company to its security holders;
- review the annual operating and capital budgets, modifications thereto, and details of any proposed financing;
- monitor the integrity of the financial reporting process and the system of internal controls that the Board and our management have established;
- monitor the management of the principal risks that could impact the financial reporting of the Company, and the Company's compliance with legal and regulatory requirements as they relate to the Company's financial statements;
- review and approve the audit plan, process, results, and performance of the Company's External Auditors and the Internal Audit department (the Internal Auditor) while providing an open avenue of communication between the Board, Management, External Auditors, and the Internal Auditor; and
- assess the qualifications and independence of the External Auditors, and recommend to the Board the nominations of the External Auditors and the compensation to be paid to the External Auditors.

The Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the External Auditors as well as anyone in the organization. The Committee has the authority to retain special legal, accounting, and other advisors or experts it deems necessary in the performance of its duties.

Each of the members of the Committee has been determined by the Board of Directors to be independent, that is, without any direct or indirect relationship with the Company that could reasonably interfere with the exercise of the member's independent judgment. Douglas E. Allen acted as interim Chief Executive Officer of the Company from October 16, 2002 until May 5, 2003.

All members of the Committee are financially literate within the meaning of Multilateral Instrument 52-110, that is, each has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements.

Since April 1, 2003, all recommendations of the Committee to nominate or compensate an External Auditor have been adopted by the Board.

The aggregate fees billed by our external auditor in each of the last two fiscal years were:

EXTERNAL AUDITOR BILLINGS		
YEAR ENDED MARCH 31 (\$ THOUSANDS)	2008	2007
Audit and audit related	182.6	172.8
Tax services	2.7	3.0
All other fees	-	7.5
Advisory services (internal control certification)	185.3	183.3

Management's Discussion & Analysis

Pursuant to its terms of reference, the Committee must pre-approve retaining the External Auditors for any non-audit service to be provided to the Company or its subsidiaries, provided that no approval shall be provided for any service that is prohibited under the rules of the Canadian Public Accountability Board or the Public Company Accounting Oversight Board, or the Independence Standards of the Canadian Institute of Chartered Accountants.

Before retaining the External Auditors for any non-audit service, the Committee must consider the compatibility of the service with the External Auditors' independence. The Committee may pre-approve retaining of the External Auditors for the engagement of any non-audit services by establishing policies and procedures to be followed prior to the appointment of the External Auditors for the provision of such services. To date, no such policies and procedures have been established. In addition, the Committee may delegate to one or more members the authority to pre-approve retaining of the External Auditors for any non-audit services to the extent permitted by applicable law.

Safety, Health, Environment & Security Committee (at March 31, 2008):

Chair: Sandy M. Fulton

Members: Doreen J. Hewitt, Gordon R. Larkin,
Maureen V. Macarenko, A. Daniel Miller,
Robert W. McCaskill,

Effective April 1, 2008, Sandy M. Fulton ceased to be a director and Chair of the Committee and A. Daniel Miller became Chair of the Committee. Also effective April 1, 2008, Donald P. Hayes and Wayne H. Stoilen became members of the Committee, and Doreen J. Hewitt and Robert W. McCaskill ceased to be directors and members of the Committee.

The Safety, Health, Environment & Security Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities. The Committee has the mandate to:

- exercise due diligence over the safety, health, environmental, and security operations of the Company;
- develop, review, and make recommendations, as required, on matters related to the Company's safety, health, environmental, and security policies and practices; and
- monitor compliance with Government regulations and with the Company's commitment to these issues.

Governance & Human Resources Committee (at March 31, 2008):

Chair: Douglas E. Allen

Members: Sandy M. Fulton, John R. Henderson,
Doreen J. Hewitt, Maureen V. Macarenko,
Graham M. Wilson

The Governance & Human Resources Committee was appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities regarding matters related to corporate governance, human resources, and director and executive compensation. Effective April 1, 2008, responsibility for matters related to corporate governance and director compensation was assigned to the Governance & Nominating Committee, and responsibility for matters related to human resources and executive compensation was assigned to the Human Resources & Compensation Committee. The Governance & Human Resources Committee ceased to exist effective April 1, 2008.

Nominating Committee (at March 31, 2008):

Chair: Elizabeth J. Harrison, Q.C.

Members: Douglas E. Allen, Sandy M. Fulton,
Graham M. Wilson

The Nominating Committee was appointed by the Board of Directors to lead the nomination processes for BCF. Effective April 1, 2008, the responsibilities for matters related to director nomination were assigned to the Governance & Nominating Committee, and the Nominating Committee ceased to exist.

Management's Discussion & Analysis

Governance & Nominating Committee (effective April 1, 2008)

Chair:	Elizabeth J. Harrison, Q.C.
Members:	Mark L. Cullen, Thomas W. Harris, Maureen V. Macarenko, Graham M. Wilson

The Governance & Nominating Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities with respect to ensuring that the corporate governance system of BCF is effective. The Committee has the mandate to:

- review, assess, and make recommendations regarding the effectiveness of the policies and practices of the Board;
- ensure the Board's continuing ability to fulfill its legislative mandate;
- implement effective due diligence over the operations of the Company;
- ensure that the Board of BCF is comprised of Board members that collectively and individually have the skills, experience, and backgrounds to appropriately lead the organization;
- establish and implement effective processes for identifying and recommending suitable candidates for appointment as directors of BCF; and
- ensure the adequacy and suitability of the compensation plan for directors to ensure it is sufficient to enable the Company to attract and retain talented and qualified individuals to serve on the Board, at a reasonable cost.

Human Resources & Compensation Committee (effective April 1, 2008)

Chair:	Douglas E. Allen
Members:	Mark L. Cullen, Thomas W. Harris, Brian G. Kenning, A. Daniel Miller

The Human Resources & Compensation Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities regarding the human resources and compensation strategies and policies of BCF. The Committee has the mandate to:

- ensure, at a strategic level, that there are appropriate and effective human resources policies in place, setting the philosophy for the employment and motivation of the Company's staff and their understanding of and engagement in the interests and success of the Company;
- regularly review with the President & CEO his plans for the structure, development, and succession of executive management; and

- establish and implement a total compensation philosophy for the President & CEO and executive management that attracts and retains Executives, links total compensation to financial performance and the attainment of short and long term strategic, operational, and financial performance, and provides competitive total compensation opportunities at a reasonable cost, while enhancing the ability to fulfill the Company's overall strategies and objectives.

Assessments

As part of its dedication to best governance practices, the Board is committed to regular assessments of the effectiveness of the Board, the board chair, committees, committee chairs and individual directors.

The Governance & Nominating Committee annually reviews and makes recommendations to the Board on the method and content for annual evaluations.

The Board has engaged an independent governance consultant to coordinate the evaluation. The assessment undertaken in the year ended March 31, 2008, involved individual discussions between each director and the independent consultant on matters related to Board effectiveness. The consultant presented the results of the evaluation to the Board and has prepared recommendations for action. The Board has adopted an action plan for the upcoming year to respond to the consultant's report and recommendations.

The Board also undertakes an assessment annually of the performance of individual directors. This occurs through discussions between the individual directors and the Board Chair.

Consolidated Financial Statements

MANAGEMENT'S RESPONSIBILITY

BC Ferries management is responsible for presentation and preparation of the annual consolidated financial statements, management's discussion and analysis ("MD&A") and all other information in this annual report.

The accompanying consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements and information in the MD&A necessarily include amounts based on management's informed judgements and best estimates. The financial information presented elsewhere in this annual report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable and accurate financial statements, management has established systems of internal control that are designed to provide reasonable assurance that assets are safeguarded from loss and that reliable financial records are maintained. These systems are monitored by management and by internal auditors. In addition, the internal auditors perform appropriate tests and related audit procedures.

The consolidated financial statements have been examined by KPMG LLP, independent chartered accountants. The external auditors' responsibility is to express a professional opinion on the fairness of management's consolidated financial statements. The auditors' report outlines the scope of their examination and sets forth their opinion.

The Board of Directors, through its Audit and Finance Committee, oversees management's responsibilities for financial reporting and internal control. The Audit and Finance Committee meets with the internal auditors, the independent auditors and management to discuss auditing and financial matters and to review the consolidated financial statements and the independent auditors' report. The Audit and Finance Committee reports its findings to the Board for consideration in approving the consolidated financial statements for issuance.



David L. Hahn
President & Chief Executive Officer



Rob Clarke
Executive Vice President & Chief Financial Officer

Consolidated Financial Statements

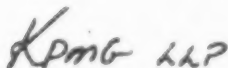
AUDITORS' REPORT

To the Shareholders of British Columbia Ferry Services Inc.

We have audited the consolidated balance sheets of British Columbia Ferry Services Inc. as at March 31, 2008 and 2007 and the consolidated statements of earnings and retained earnings and cash flows for each of the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants

Victoria, Canada
May 16, 2008

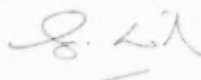
Consolidated Financial Statements

CONSOLIDATED BALANCE SHEETS (EXPRESSED IN THOUSANDS)

AS AT MARCH 31	2008	2007
Assets		
Current assets:		
Cash and cash equivalents (note 2(d))	\$ 130,409	\$ 180,123
Short-term investments (note 2(d))	17,040	16,046
Accounts receivable	16,234	19,050
Prepaid expenses	7,285	5,879
Inventories	17,055	16,492
Derivative assets (note 3)	16,373	-
Regulatory assets (note 4)	4,775	-
	209,171	237,590
Capital assets (note 5)	1,303,644	918,824
Deferred financing costs	669	9,580
Regulatory assets (note 4)	7,729	21,721
Long-term land lease (note 6)	29,238	28,060
	\$ 1,550,451	\$ 1,215,775
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 91,263	\$ 72,511
Short-term debt (note 2)	-	24,888
Interest payable on long-term debt	15,718	12,663
Accrued employee costs	53,213	47,393
Deferred revenue	15,108	12,031
Regulatory liabilities (note 4)	3,558	90
Current portion of accrued employee future benefits	800	800
Current portion of obligations under capital leases	690	26
	180,350	170,402
Accrued employee future benefits (note 7)	13,020	13,755
Derivative liabilities (note 3)	-	2,831
Regulatory liabilities (note 4)	16,833	-
Long-term debt (note 2)	1,028,872	749,628
Obligations under capital leases (note 8)	719	112
Other long-term liabilities	76	-
	1,239,870	936,728
Shareholders' equity:		
Share capital (note 9)	75,478	75,478
Retained earnings	235,103	203,569
	310,581	279,047
Commitments (notes 5 and 14)		
Contingent liabilities (note 17)		
	\$ 1,550,451	\$ 1,215,775

See accompanying notes to consolidated financial statements.

On behalf of the Board:



Director, Graham M. Wilson



Director, Elizabeth J. Harrison, QC

Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF EARNINGS, COMPREHENSIVE INCOME AND RETAINED EARNINGS (EXPRESSED IN THOUSANDS)

YEARS ENDED MARCH 31	2008	2007
Revenue:		
Tariffs	\$ 382,229	\$ 363,228
Ferry service fees (note 10)	122,702	108,396
Federal-Provincial Subsidy Agreement (note 11)	25,856	25,309
Retail	79,235	72,028
Other income	30,707	27,318
	640,729	596,279
Expenses:		
Operations	334,743	309,121
Maintenance	88,412	84,886
Administration	49,765	50,615
Cost of retail goods sold	29,936	28,226
Amortization	66,793	55,515
	569,649	528,363
Earnings from operations	71,080	67,916
Gain on foreign exchange	130	344
Interest expense (note 12)	(33,127)	(19,292)
Loss on disposal of capital assets	(989)	(183)
Net earnings before extraordinary gain	37,094	48,785
Extraordinary gain (note 13)	-	61,272
Net earnings	37,094	110,057
Other comprehensive income (note 1(b))	-	-
Net earnings and comprehensive income	37,094	110,057
Retained earnings, beginning of year	203,569	99,550
Adjustment to retained earnings (note 1(b))	478	-
Restated balance, beginning of year	204,047	99,550
Preferred share dividend (note 9)	(6,038)	(6,038)
Retained earnings, end of year	\$ 235,103	\$ 203,569

See accompanying notes to consolidated financial statements.

Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS (EXPRESSED IN THOUSANDS)

YEARS ENDED MARCH 31	2008	2007
Cash provided by (used in):		
Operations:		
Net earnings before extraordinary gain	\$ 37,094	\$ 48,785
Extraordinary gain (note 13)	-	61,272
Net earnings	37,094	110,057
Items not involving cash		
Amortization	66,793	55,515
Other non-cash charges	1,522	(1,897)
Long-term regulatory costs deferred	11,622	3,893
Change in operating working capital	6,630	(7,108)
	123,661	160,460
Financing:		
Dividends paid on preferred shares	(6,038)	(6,038)
Deferred financing costs incurred	(1,787)	(1,895)
Repayment of capital lease obligations	(835)	-
Proceeds from issuance of bonds and other long-term debt	290,000	250,000
Proceeds from short-term loans	39,836	203,843
Repayment of short-term loans	(64,544)	(179,135)
	256,632	266,775
Investing:		
Proceeds from disposal of capital assets	51	31
Purchase of capital assets	(427,504)	(248,316)
Increase in lands under long-term lease	(1,560)	(60)
Purchase of short-term investments	(994)	(1,058)
	(430,007)	(249,403)
(Decrease) increase in cash and cash equivalents	(49,714)	177,832
Cash and cash equivalents, beginning of year	180,123	2,291
Cash and cash equivalents, end of year	\$ 130,409	\$ 180,123
Supplemental cash flow information:		
Cash paid during the year for interest	\$ 43,064	\$ 31,202
Non-cash transactions:		
Capital assets acquired under capital lease	\$ 2,106	\$ -

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(COLUMNAR DOLLARS EXPRESSED IN THOUSANDS)

British Columbia Ferry Services Inc. (the "Company") was incorporated under the *Company Act* (British Columbia) by way of conversion on April 2, 2003, and now validly exists under the *Business Corporations Act* (British Columbia). The Company's primary business activity is the provision of coastal ferry services in British Columbia.

The Company is subject to the *Coastal Ferry Act* (the "Act"), which came into force on April 1, 2003. Its common share is held by the B.C. Ferry Authority, a corporation without share capital, and it is regulated by the British Columbia Ferries Commissioner (the "Commissioner") to ensure that rates are fair and reasonable and to monitor service levels.

1. Significant accounting policies:

(a) Basis of presentation:

The consolidated financial statements of the Company are prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Deas Pacific Marine Inc. ("DPM"), Pacific Marine Leasing Inc. ("PML"), BCF Captive Insurance Company Ltd. ("BCF Captive") and Pacific Marine Ventures Inc. ("PMV"). All inter-company balances and transactions have been eliminated on consolidation. DPM was dissolved on April 1, 2007 and is no longer a separate legal entity. PML commenced operations in January 2007. BCF Captive was incorporated in March 2005, and commenced operations April 1, 2005. PMV was incorporated on March 15, 2007 and commenced operations on September 4, 2007.

(b) Adoption of new accounting standards:

Effective April 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants (CICA) Handbook Sections 1530 "Comprehensive Income," 3251 "Equity," 3855 "Financial Instruments - Recognition and Measurement," 3861 "Financial Instruments - Disclosure and Presentation," and 3865 "Hedges." These new Handbook Sections provide comprehensive requirements for the recognition and measurement of financial instruments, as well as standards on when and how hedge accounting may be applied. Handbook Section 1530 also establishes standards for reporting and displaying comprehensive income. Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with generally accepted accounting principles.

Under these new standards, all financial instruments are classified into one of the following five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities.

The Company has classified its financial instruments into the five categories as follows:

Cash and cash equivalents	
(Cash)	Available-for-sale
(Investments with maturities less than 3 months)	Held-to-maturity
(Other cash equivalents)	Held for trading
Short-term investments	Held-to-maturity
Accounts receivable	Loans and receivables
Derivative assets	Held for trading
Accounts payable and accrued liabilities	Other financial liabilities
Short-term debt	Other financial liabilities
Interest payable on long-term debt	Other financial liabilities
Accrued employee costs	Other financial liabilities
Derivative liabilities	Held for trading
Long-term debt	Other financial liabilities

All financial instruments, including derivatives, are included on the consolidated balance sheet and are initially measured at fair value. Subsequent measurement and recognition of changes in fair value of financial instruments depends on their initial classification. Held for trading financial instruments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet. Loans and receivables, investments held-to-maturity and other financial liabilities are measured at amortized cost.

The standards require derivative instruments to be recorded as either assets or liabilities measured at their fair value unless exempted from derivative treatment as a normal purchase and sale. Certain derivatives embedded in other contracts must also be measured at fair value. All changes in the fair value of derivatives are recognized in earnings unless specific hedge criteria are met, which requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting.

The adoption of these standards has the following effect on the consolidated financial statements for the twelve months ended March 31, 2008:

- (1) Recognition of foreign currency forward contracts as derivative assets and liabilities in the consolidated financial statements (note 3);
- (2) Restatement of opening retained earnings at April 1, 2007 to recognize the prior years' earnings effect of accounting for long-term debt using the effective interest rate method; and
- (3) Reclassification of deferred financing costs to long-term debt (note 2).

Notes to Consolidated Financial Statements

1. Significant accounting policies (continued):

(b) Adoption of new accounting standards (continued):

The Company also de-designated all previously designated hedges on June 30, 2007 under Section 3865 – “Hedges.” All of these hedges, which were entered into to provide greater certainty of the cost of new vessel acquisitions denominated in foreign currencies, were effective at the time of de-designation. All hedges are recorded at fair value with unrealized gains and losses recorded to the regulatory asset or liability accounts on the balance sheet.

Upon adoption of the new standards, the Company reviewed all of its outstanding contracts subsequent to the elected transition date of April 1, 2003 to determine if any were derivatives or contained embedded derivatives. As at March 31, 2008, the Company has no embedded derivatives that meet the requirements of Section 3855 which would require that they be separated from host contracts and valued separately at fair value.

The Company has not recognized any adjustments through other comprehensive income for the twelve months ended March 31, 2008.

The adoption of these sections is done prospectively without restatement of the consolidated financial statements of prior periods. As at April 1, 2007, the impact on the consolidated financial statements of recording foreign currency forward contracts as derivative assets and liabilities, measuring the long-term debt using the effective interest rate method and reclassifying the deferred financing costs directly attributable to the issuance of the long-term debt is summarized in the table below:

	APRIL 1, 2007	MARCH 31, 2007	NET IMPACT
Derivative assets	\$ 8,625	\$ -	\$ 8,625
Other assets – deferred financing costs	1,017	9,580	(8,563)
Derivative liabilities	18,677	2,831	15,846
Long-term debt	740,587	749,628	(9,041)
Retained earnings	204,047	203,569	478

In the table above, the remaining balance of deferred financing costs at April 1, 2007 represent costs incurred for long-term debt arranged for but not yet issued.

(c) Regulation:

The Company is regulated by the Commissioner to ensure that tariffs are fair and reasonable and to monitor service levels. In order to recognize the economic effects of regulation, the timing of recognition of certain revenues and expenses may differ from that otherwise expected under generally accepted accounting principles. These timing differences give rise to regulatory assets and regulatory liabilities in the financial statements.

The Company follows Accounting Guideline 19 “Disclosures by Entities Subject to Rate Regulation” (AcG-19) of the CICA Handbook (Handbook) which establishes guidelines on certain aspects of the disclosure and presentation of information in the financial statements of entities subject to rate regulation. AcG-19 requires the disclosure of general information regarding the nature and economic effects of rate regulation, as well as, additional information on how rate regulation has affected the financial statements (note 4). The guideline does not address recognition and measurement issues associated with the accounting for rate-regulated operations.

(d) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash and investments that are highly liquid in nature and generally have a maturity date of three months or less.

(e) Short-term investments:

Short-term investments are valued at the lower of cost or market value and consist of financial instruments with original maturity dates greater than three months.

(f) Inventories:

Inventories, which consist of materials and supplies, catering stores and fuel, are valued at the lower of weighted-average cost and current replacement cost.

(g) Capital assets:

The costs of major replacements, additions, extensions and improvements, including direct overhead and financing costs during construction are capitalized. The costs of maintenance, repairs, refit and minor renewals or replacements are expensed as incurred.

Capital assets, including assets under capital leases, are amortized on a straight-line basis over the estimated useful lives of the assets at the following rates:

ASSET CLASS	ESTIMATED USEFUL LIFE
Ship hulls	40 years
Ship propulsion and utility systems	20 to 30 years
Marine structures	20 to 40 years
Buildings	20 to 40 years
Equipment and other	3 to 20 years

Notes to Consolidated Financial Statements

(h) Impairment of long-lived assets:

The Company reviews capital assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparison of their carrying amount to the future undiscounted cash flows the assets are expected to generate. If such capital assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying amount of the assets exceeds their fair market value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(i) Revenue recognition:

Tariff revenue is recognized when transportation is provided. The value of pre-sold fare media is included in the balance sheets as deferred revenue.

(j) Pension and other employee future benefit plans:

Defined contribution plan accounting is applied to the Company's multi-employer defined benefit pension and long-term disability plans. These multi-employer plans are administered by external parties and the Company does not have sufficient information to apply defined benefit plan accounting.

The actuarial determination of the accrued benefit obligations for retirement benefits other than pension uses the projected benefit method prorated on service (which incorporates management's best estimate of future salary levels, other cost escalation, retirement ages of employees and other actuarial factors).

For the purpose of calculating the expected return on plan assets, those assets are valued at fair value.

Actuarial gains (losses) arise from the difference between actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligation. For the Company's retirement bonus and death benefit plans, the excess of the net accumulated actuarial gain (loss) over 10 percent of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees. The average remaining service period of the active employees covered by the other (non-pension) retirement benefits plan was 7.1 years as at March 31, 2007, the date of the most recent actuarial valuation.

Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment.

When the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

(k) Use of estimates:

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported

amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the valuation of assets held for resale, the economic life of capital assets and the corresponding period of amortization, the recoverability of capital assets, the valuation of employee future benefits, and provisions for contingencies. Actual results could differ from these estimates.

(l) Taxes:

The Company is a "Tax Exempt Corporation" as described in the *Income Tax Act* and as such, is exempt from federal and provincial income taxes.

The provision of vehicle and passenger ferry services is an exempt supply under the *Excise Tax Act* for GST purposes.

(m) Foreign currency transactions:

The Company's normal operating currency is the Canadian dollar. Monetary assets and liabilities denominated in foreign currency are translated to Canadian dollars at the rate of exchange prevailing at the balance sheet date. Revenues and expenses are translated at rates in effect at the time of the transaction. Foreign exchange gains and losses are recognized in the statement of earnings during the year in which they arise.

(n) Debt transaction costs:

Legal and financing costs incurred for long-term debt arranged for are capitalized. Once the debt is issued these costs are reclassified from deferred costs to long-term debt which is measured using the effective interest rate method.

(o) Hedging relationships:

Derivative financial instruments are utilized by the Company to manage market risk against the volatility in foreign currency, interest rate, and fuel price exposures. The Company does not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge the company determines whether it will or will not apply hedge accounting.

When applying hedge accounting, the Company documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also assesses, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. Realized and unrealized gains or losses associated with derivative instruments which have been terminated or cease to be effective prior to maturity are recognized in the period in which they have been terminated or cease to be effective.

Notes to Consolidated Financial Statements

1. Significant accounting policies (continued):

(p) Asset retirement obligations:

In the period when it can be reasonably determined, the Company recognizes a liability at its fair value for any legal obligations associated with the retirement of long-lived assets when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is added to the carrying amount of the related asset and amortized to expense on a systematic and rational basis.

It is possible that the Company's estimates of its ultimate asset retirement obligations could change as a result of changes in regulations, changes in the extent of environmental remediation required, changes in the means of reclamation or changes in cost estimates. Changes in estimates are accounted for prospectively from the period the estimate is revised.

The Company's long-lived assets include certain vessels which contain undetermined amounts of asbestos. Under certain circumstances the Company may be required to handle and dispose of the asbestos in a manner required by regulations. It is the Company's intention to sell decommissioned vessels into world markets for continued use in providing commercial ferry service. Under these circumstances asbestos remediation would become the responsibility of the new owner.

No amount has been recorded for asset retirement obligations relating to these assets as it is not possible to make a reasonable estimate of the fair value of any such liability due to the indeterminate magnitude, likelihood or financial impact, if any, of this issue.

(q) Interest rate support:

The Company receives interest rate support from the Government of Canada for eligible new Canadian built vessels or major refurbishment of vessels. Amounts receivable in regard to capitalized interest are recognized as a reduction of capitalized interest upon completion of the project. Amounts receivable in regard to post-completion debt service costs are recognized as a reduction to interest expense.

(r) Comparative figures:

Certain comparative figures have been reclassified to conform to the presentation adopted for the current period.

(s) Future accounting changes:

International Financial Reporting Standards ("IFRS"): In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. During March 2008 the AcSB confirmed the adoption transition dates for conversion to IFRS. The Company's transition date for the conversion to IFRS will be April 1, 2011 and will require the restatement for comparative purposes of amounts reported by the Company for the year

ended March 31, 2011. While the Company has begun assessing the adoption of IFRS, the financial reporting impact of the transition cannot be reasonably estimated at this time.

Rate-Regulated Operations:

In March 2007, the AcSB issued an Exposure Draft on rate-regulated operations that proposed: (i) the temporary exemption in Section 1100, "Generally Accepted Accounting Principles," of the CICA Handbook providing relief to entities subject to rate regulation from the requirement to apply the Section to the recognition and measurement of assets and liabilities arising from rate regulation be removed; (ii) the explicit guidance for rate-regulated operations provided in Section 1600, "Consolidated Financial Statements," Section 3061, "Property, Plant & Equipment," Section 3465, "Income Taxes," and Section 3475, "Disposal of Long-Lived Assets and Discontinued Operations," be removed; and (iii) Accounting Guideline 19, "Disclosure by Entities Subject to Rate Regulation," be retained as is. The AcSB has also observed that relying on US Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" ("FAS 71"), as another source of Canadian GAAP in the absence of CICA Handbook guidance addressing the specific circumstances of entities subject to rate regulation, is consistent with Section 1100 when the qualifying criteria of FAS 71 are met.

In August 2007, the AcSB issued a Decision Summary on the Exposure Draft that supported the removal of the temporary exemption in Section 1100, "Generally Accepted Accounting Principles," and the amendment to Section 3465, "Income Taxes," to recognize future income tax liabilities and assets as well as an offsetting regulatory asset or liabilities for entities subject to rate regulation. Both changes will apply prospectively for the Company beginning April 1, 2009. It was also decided that the current guidance pertaining to property, plant and equipment and disposal of long-lived assets and discontinued operations and consolidated financial statements be maintained and that the existing AcG-19 will not be withdrawn from the Handbook but that the guidance will be updated as a result of the other changes. The AcSB also decided that the final Background Information and Basis for Conclusions associated with its rate regulation project would not express any views of the AcSB regarding the status of FAS 71, as an "other source of GAAP" within the Canadian GAAP hierarchy. The Company does not expect application of these changes to have any impact on the consolidated financial statements. The Company is continuing to monitor any additional implications on its financial reporting related to accounting for rate regulated operations.

Inventories:

Section 3031 "Inventory" replaces Section 3030 and becomes effective for the Company beginning April 1, 2008. This section provides guidance on the determination of inventory cost, subsequent recognition as expense, and write-downs to net realizable value. The Company does not expect application of this section to have a significant impact on the consolidated financial statements.

Notes to Consolidated Financial Statements

Capital disclosures:

Section 1535 "Capital Disclosures" becomes effective for the Company beginning April 1, 2008. This section establishes standards for disclosing information about the Company's capital and how it is managed. The standard requires disclosures of the Company's objectives, policies and processes for managing capital, the quantitative data about what the Company regards as capital, whether the Company has complied with any capital requirements and if it has not complied, the consequences of such non-compliance. The Company does not expect application of this section to have a significant impact on the consolidated financial statements.

Disclosure and presentation of financial instruments:

Section 3862 "Financial Instruments - Disclosure" becomes effective for the Company beginning April 1, 2008. This section requires disclosures, by class of financial instrument, which will enable users to evaluate the significance of financial instruments for the Company's financial position and performance, including disclosures about fair value.

In addition, disclosure is required of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk, and market risk. The quantitative disclosures must also

include a sensitivity analysis for each type of financial market risk to which an entity is exposed, showing how net earnings and other comprehensive income would have been affected by reasonably possible changes in the relevant risk variable. The Company does not expect application of this section to have a significant impact on the consolidated financial statements.

Section 3863 "Financial Instruments - Presentation" becomes effective for the Company beginning April 1, 2008. Under this new section, the existing requirements on presentation of financial instruments are carried forward unchanged, and accordingly, the Company does not expect application of this section to have any impact on the consolidated financial statements.

Intangibles:

Section 3084 "Goodwill and Intangible Assets" replaces Sections 3062 and 3450 and becomes effective for the Company beginning April 1, 2009. This section does not substantively change the requirement pertaining to goodwill. The changes in requirements pertaining to intangible assets primarily relate to recognition criteria for purchased and internally developed assets which will result in few intangible assets being recognized on the balance sheet. The Company is assessing the impact of this section on the consolidated financial statements.

2. Loans:

AS AT MARCH 31	2008	2007
Long-term debt:		
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (effective interest rate 5.92%) (a)	\$ 250,000	\$ 250,000
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate 6.41%) (a)	250,000	250,000
5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate 5.06%) (a)	250,000	250,000
5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate 5.62%) (a)	200,000	-
4.98% Loan, due March 2016 (effective interest rate 5.10%) (b)	90,000	-
Less: Deferred financing costs and unamortized bond discounts	(11,128)	(372)
	\$ 1,028,872	\$ 749,628

In May 2004, the Company entered into a master trust indenture which established common security and a set of common covenants for the benefit of all lenders under the Company's financing plan. The financing plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings, ranking pari passu.

The Company has issued four bond series of obligation bonds under the master trust indenture and entered into a credit facility agreement. In addition, the Company has entered into loan agreements which make up to \$180 million available to partially finance the Company's purchase of two Super 'C' class vessels. These funds are released to coincide with the conditional acceptance of the vessels one of which occurred in February 2008 and the other is expected later in 2008. The master trust indenture requires the Company to maintain debt service reserves for all series of obligation bonds.

Notes to Consolidated Financial Statements

2. Loans (continued):

The CICA recommendations regarding the measurement of financial liabilities require that they be measured at initial recognition using the effective interest rate method. Accordingly, deferred financing costs and unamortized bond discounts have been recalculated using the effective interest rate method. Commencing April 1, 2007, in accordance with CICA recommendations regarding the presentation of financial liabilities, long term debt has been reduced by the cumulative unamortized balance of deferred financing costs and unamortized bond discounts.

(a) Bonds:

Bonds are issued under supplemental indentures either as obligation bonds or as pledged bonds. The bonds are secured by a registered first mortgage and charge over vessels, an unregistered first mortgage and charge over ferry terminal leases, and by a general security agreement on property and contracts. The bonds are redeemable in whole or in part at the option of the Company. Interest on the Series 04-1 bonds is payable semi-annually on May 27 and November 27 of each year until maturity. Interest on the Series 04-4 bonds is payable semi-annually on April 13 and October 13 of each year until maturity. Interest on the Series 07-1 bonds is payable semi-annually on March 20 and September 20 of each year until maturity. Interest on the Series 08-1 bonds is payable semi-annually on January 11 and July 11 of each year until maturity.

(b) 4.98% Loan:

Proceeds of \$90.0 million were received in February 2008 for the partial financing of the purchase of the *Coastal Inspiration* to coincide with conditional acceptance from the shipyard. Quarterly payments are due on March 16, June 16, September 16 and December 16 for each year of the term of the loan. The agreement defers the principal payments for the first three years to a second tranche on which interest only is paid quarterly and the principal is paid at the end of the term.

(c) Credit facility:

During the quarter ended June 30, 2007, the Company negotiated an amendment agreement to the credit facility with a syndicate of Canadian banks, secured by pledged bonds. This revolving facility, in the amount of \$155 million, matures May 12, 2012. The amendment includes a provision giving the Company, on an annual basis, an option to request a one year extension. There were no draws on this facility as at March 31, 2008 (March 31, 2007: \$25.0 million shown as short-term debt at their discounted value \$24.9 million). Interest expensed during the year ended March 31, 2008 was \$0.3 million (March 31, 2007: \$1.1 million).

(d) Debt service reserves:

The Company is required to maintain debt service reserves for the Series 04-1, 04-4, 07-1 and 08-1 bonds equal to not less than six months forecasted debt service, to be increased under certain conditions. A further debt service reserve is required to be maintained for the 4.98% loan equal to the sum of the first two interest payments. As at March 31, 2008, debt service reserves of \$15.0 million were invested in short-term investments and \$14.1 million in cash equivalents. As at March 31, 2007, \$14.1 million was invested in short-term investments and \$7.2 million in cash equivalents.

3. Derivative assets and liabilities:

The fair value as at March 31, 2008 of financial derivative assets for foreign currency hedges is \$16.4 million. The carrying value as at March 31, 2007 of financial derivative instruments not initially designated as foreign currency hedges was a liability of \$2.8 million.

4. Financial statement effect of rate regulation:

The Company is regulated by the Commissioner to ensure that tariffs are fair and reasonable and to monitor service levels. Under the terms of the Act, the tariffs the Company charges its customers are subject to price caps. Annual increases in price caps were set for the first five year term through March 31, 2008. The Commissioner may, under certain circumstances, allow increases in price caps over the set levels. The Commissioner has set price caps for the second four year term through March 31, 2012 (the "second performance term") and will establish the price caps to apply for each subsequent term.

The accounting for regulated operations of the Company may differ from non-regulated businesses following GAAP. As a result, the Company records assets and liabilities that result from the regulated price cap setting process that would not be recorded under GAAP for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because they are probable of future recovery in tariffs. Regulatory liabilities represent obligations to customers which will be settled through future tariffs. Management continually assesses whether the regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes and believes the existing regulatory assets are probable of recovery. This determination reflects the current regulatory climate, and is subject to change in the future. If future recovery of costs ceases to be probable, asset write-offs would be required to be recognized in the current period earnings at that time.

Notes to Consolidated Financial Statements

Accounting for the impacts of rate regulation has resulted in recording the following regulatory assets and liabilities in the consolidated balance sheets:

AS AT MARCH 31	2008	2007
Regulatory assets – Current		
Deferred fuel costs (a)	\$ 4,625	\$ -
Performance term submission costs (b)	150	-
Total current regulatory assets	\$ 4,775	\$ -
Regulatory assets – Long term		
Deferred fuel costs (a)	\$ 7,279	\$ 18,819
Performance term submission costs (b)	450	532
Hedge losses – vessel construction contracts (c)	-	2,370
Total long-term regulatory assets	\$ 7,729	\$ 21,721
Regulatory liabilities – Current		
Tariffs in excess of price cap (d) – current	\$ 3,558	\$ 90
Regulatory liabilities – Long term		
Hedge gains – vessel contracts (c)	\$ 16,833	\$ -

(a) Deferred fuel costs:

As prescribed by regulatory order, the Company defers fuel costs in excess of approved fuel costs which were used to develop the regulated price caps. The difference between the approved fuel costs and the actual fuel costs (including fuel hedge gains and losses) is deferred for recovery from future tariffs. Also prescribed by regulatory order, the Company collected fuel surcharges which have been applied against deferred fuel costs and has included interest in the amount to be recovered.

The Commissioner has considered \$18.5 million of deferred fuel costs in the determination of the price caps set for the four years beginning April 1, 2008 and it is expected that recovery will occur over this four year period. The difference between the balance in the deferred fuel cost accounts and this \$18.5 million will form the opening balances of the fuel cost deferral accounts for the second performance term.

During March 2008 the Province of British Columbia entered into an agreement with the Company to pay \$1.3 million to be applied against the balance of deferred fuel costs. If the Company was not a regulated entity, earnings for the year ended March 31, 2008 would have been \$7.0 million higher (2007: \$3.9 million higher), except for this deferral.

(b) Performance term submission costs:

The Commissioner has authorized the Company to defer costs of representation associated with the second performance term. The Commissioner has considered these costs in the determination of the price caps set for the four years beginning April 1, 2008. The Commissioner has not included an allowance for a return on investment for this item. The recovery period will be the four year period of the second performance term, commencing April 1, 2008. If the Company was not a regulated entity, earnings for the year ended March 31, 2008 would have been \$0.1 million lower (2007: \$0.4 million lower), except for this deferral.

Notes to Consolidated Financial Statements

4. Financial statement effect of rate regulation (continued):

(c) Hedge gains or losses – vessel construction contracts:

The Company defers gains or losses on financial derivative instruments which have been entered into to manage market risk against fluctuations in the Canadian dollar equivalent of vessel construction contracts denominated in foreign currencies. The intent and effect of these transactions is to provide greater certainty of the cost of the related new vessel acquisitions. The total cost of these assets, including hedge gains or losses, has been determined by the Commissioner to be reasonable and will be taken into account in the determination of price caps set for the periods following the entry of these assets into service. It is expected that the settlement or recovery period of hedge gains or losses is five to forty years. If the Company was not a regulated entity earnings for the year ended March 31, 2008 would have been \$19.2 million higher (2007: \$ 2.4 million lower), except for this deferral.

(d) Tariffs in excess of price cap:

The Act contains provisions which ensure that if tariffs charged by the Company exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At March 31, 2008, tariffs charged to customers on the major route group exceeded the price cap by \$3.4 million (2007: nil) and the tariffs charged to customers on the Bear Cove – Mid Coast route group exceeded the price cap by \$0.2 million (2007: \$0.1 million). The Bear Cove – Mid Coast route group will be discontinued as a separate route group and combined with the Northern route group effective April 1, 2008. These excess amounts will be returned to customers through tariffs over the next several months, in the absence of rate regulated accounting, GAAP would require these revenues to be recognized as income in the period collected, and earnings for the year ended March 31, 2008 would have been \$3.5 million higher (2007: \$0.9 million lower), except for this deferral.

5. Capital assets:

MARCH 31, 2008		COST	ACCUMULATED AMORTIZATION	NET BOOK VALUE
Vessels	\$	1,223,364	\$ 560,719	\$ 662,645
Berths, buildings and equipment		111,439	80,397	31,042
Berths, buildings and equipment under capital lease		532,678	236,695	295,983
Land		1,406	-	1,406
Construction-in-progress		312,568	-	312,568
	\$	2,181,455	\$ 877,811	\$ 1,303,644

MARCH 31, 2007		COST	ACCUMULATED AMORTIZATION	NET BOOK VALUE
Vessels	\$	1,006,968	\$ 522,112	\$ 484,856
Berths, buildings and equipment		102,894	70,273	32,621
Berths, buildings and equipment under capital lease		488,098	225,414	262,684
Land		1,406	-	1,406
Construction-in-progress		137,257	-	137,257
	\$	1,736,623	\$ 817,799	\$ 918,824

For the year ended March 31, 2008 capitalized financing costs during construction amounted to \$10.4 million (2007: \$6.7 million).

Amortization expense for assets under capital lease for the year ended March 31, 2008 amounted to \$14.5 million (2007: \$12.7 million).

In addition to the construction-in-progress referenced above, contractual commitments, at March 31, 2008 for capital assets to be constructed totaled \$346.3 million (2007: \$489.8 million). Included in the contractual commitments as at March 31, 2008

is \$127.8 million committed for design and construction of two "Super C" Class vessels (2007: \$293.5 million for three of these vessels), \$119.8 million (2007: \$126.5 million) for design and construction of a new vessel for use on the north coast, and \$24.2 million (2007: \$36.3 million) committed to procure an intermediate class vessel. Delivery of the first two "Super C" class vessels occurred in December 2007 and March 2008 respectively, while delivery of the third vessel is scheduled to occur in mid 2008. Delivery of the intermediate class vessel and the new north coast vessel is scheduled to occur in mid 2008 and mid 2009 respectively.

Notes to Consolidated Financial Statements

6. Long-term land lease:

On April 1, 2003, the Company's land and structures comprising its terminals were transferred by the Company to the BC Transportation Financing Authority ("BCTFA"), a British Columbia Crown Corporation and related party at the time of the transaction. In exchange, the Company received recognition of a prepayment for leases of the transferred terminal structures and land. The structures, having lives of less than the lease term, are considered a capital lease and, as such, have been capitalized and included with capital assets and are amortized in accordance with the Company's amortization policy.

The land, having an indefinite useful life, is considered an operating lease. The prepayment of the land lease has been deferred and will be amortized on a straight-line basis over eighty years, being the initial sixty year lease period, plus an additional twenty year bargain renewal option. The transaction is reflected at the book values of the transferred terminal structures and land.

During the year ended March 31, 2005, the Company entered into an agreement with BCTFA in which the Company would make improvements to the highways approaching Horseshoe Bay and Swartz Bay terminals in exchange for increased lands under the existing land lease. As at March 31, 2006, the improvements were complete. Long-term land lease was increased by the cost of these highway improvements. The increases to long-term land lease are being amortized over the remaining lease period, commencing the month following completion of improvements.

During the year ended March 31, 2008, the Company created land by filling in part of the water lot at Departure Bay terminal. The Company entered into an agreement with the Province of British Columbia that provides a licence of occupation, with the expectation that it will be added to the land lease once work currently planned for this terminal under a Master Concept Plan is completed. Long-term land lease has been increased by the cost of this improvement.

7. Accrued employee future benefits:

(a) Description of benefit plans:

The Company and its employees contribute to the Public Service Pension Plan (the "Plan"). The Pension Corporation of the Province of British Columbia administers the Plan, including the payment of retirement and post-employment benefits on behalf of employers. The Plan is a multi-employer defined benefit pension plan. Under joint trusteeship, which became effective January 1, 2001, the risk and reward associated with the Plan's unfunded liability or surplus is shared between the employers and the plan members and will be reflected in their future contributions.

In addition, eligible employees are entitled to other retirement and future benefits as provided for under the collective agreement and terms of employment. A retirement bonus and a death benefit, both unfunded defined benefit plans, and both administered by the Company, are based on years of service and final average salary. A funded long-term disability multi-employer plan provides disability income benefits after employment, but before retirement.

The Company also administers an unfunded accumulated sick leave bank ("Sick Bank obligation"), consisting of unused sick time credits, earned prior to the discontinuation of the sick leave accumulation benefit, in 1979. Accumulated sick leave may be drawn down at 100%, or paid out at 50%. Benefits are paid out at current salary rates. No new credits are accumulated to this bank.

The Company's employees may also receive compensation benefits arising from claims prior to March 31, 2003 administered by the Workers' Compensation Board ("WCB obligation"). Prior to March 31, 2003, the Company participated in the Workers' Compensation Board deposit class coverage system. Subsequent to March 31, 2003 the Company has been covered under the Workers' Compensation Board rate system. The change to the rate system resulted in a residual liability from the deposit class system that has been valued by actuarial assumptions as appropriate for a closed plan. Currently this obligation is unfunded.

(b) Total cash payments:

Total cash payments for employee future benefits for the year ended March 31, 2008, consisting of cash contributed by the Company to its multi-employer defined benefit plans, cash payments directly to beneficiaries for its unfunded other benefit plans, and cash contributed to a third party administrator of an unfunded plan, was \$21.7 million (2007: \$20.7 million).

(c) Defined benefit plans:

All of the Company's defined benefit plans, except its multi-employer plans, are currently unfunded. The most recent actuarial valuation of the retirement bonus and death benefit plans is as at March 31, 2007. A plan amendment at December 31, 2007 restricts exempt employees from joining the retirement bonus and death benefit plans. This has resulted in a negative past service cost, which is being amortized over the average remaining service period of the active employee group covered by the plans commencing January 1, 2008. The most recent actuarial valuations of the WCB obligation and the Sick Bank obligation are as at March 31, 2006 and March 31, 2001, respectively.

Notes to Consolidated Financial Statements

7. Accrued employee future benefits (continued):

OTHER BENEFIT PLANS

Accrued benefit obligations	2008	2007
Balance, beginning of year	\$ 15,444	\$ 18,378
Current service cost	497	481
Interest cost	752	783
Benefits paid	(2,090)	(2,418)
Actuarial (gains) losses	1,917	(1,780)
Plan amendment – past service cost	(1,441)	-
Balance, end of year	\$ 15,079	\$ 15,444

Reconciliation of funded status of the benefit plans to the amounts recorded in the financial statements

Fair value of plan assets	\$ -	\$ -
Accrued benefit obligation	15,079	15,444
Funded status of plans – deficit	(15,079)	(15,444)
Unamortized net actuarial loss	2,649	889
Unamortized plan amendment – past service cost	(1,390)	-
Accrued benefit liability	(13,820)	(14,555)
Current portion of accrued employee future benefits	800	800
Accrued employee future benefits	\$ (13,020)	\$ (13,755)

Elements of defined benefit costs recognized in the year

Current service cost, net of employee contributions	\$ 497	\$ 481
Interest cost	752	735
Actuarial (gains) losses	158	(1,780)
Plan amendments	(51)	-
Defined benefit costs recognized	\$ 1,356	\$ (564)

Significant assumptions

The significant assumptions used are as follows (weighted average):

Accrued benefit obligation as of March 31:		
Discount rate	5.0%	5.6%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	92.0%	92.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%
Benefit cost for years ended March 31:		
Discount rate	5.0%	5.6%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	92.0%	92.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%

Notes to Consolidated Financial Statements

(d) Multi-employer plans:

The total cost recognized for the Company's multi-employer plans is as follows:

	2008		2007	
Public Service Pension Plan contributions (i)	\$	17,356	\$	16,222
Long-term disability plan contributions		2,266		2,097
Long-term disability plan amortization of surplus (ii)		64		64
	\$	19,686	\$	18,383

- i) The March 31, 2005 actuarial valuation report for the Public Service Pension Plan was received by the Public Service Pension Board of Trustees on December 14, 2005. This report indicated that the pension fund has an unfunded liability of \$767 million. Under the terms of the plan's joint trust agreement, plan members and employers share in any increase or decrease in contribution rates. In order to address the unfunded liability, the plan trustees have increased the member and employer contribution rates by 1.88%, effective April 1, 2006. The next valuation will be as at March 31, 2008.
- ii) Contribution rates for the long-term disability plan are actuarially determined every three years as a percentage of covered payroll. An interim valuation, as at March 31, 2007, determined a fund deficit and the employer contribution rate will increase from 1.52% to 1.81% of covered payroll to address this deficit. Then next scheduled valuation will be as at March 31, 2008.

8. Obligations under capital lease:

During the year ended March 31, 2005, the Company entered into a lease agreement for a training facility. The initial lease period is for a term of ten years, expiring April, 2015. The Company may, at its option, extend the lease term for up to two periods of five years each. Use of the facility by other organizations is controlled by the Company during the lease period. A discount rate of 6.25% has been used to determine the present value of the obligation under capital lease.

The Company also enters into lease agreements with terms of three or four years for computer equipment. Discount rates of 5.06% and 5.62% have been used to determine the present value of these obligations. During the year ended March 31, 2008, \$2.1 million of leased computer equipment was added to capital assets.

Future minimum lease payments:

YEAR ENDED	
2009	\$ 782
2010	473
2011	303
2012	88
2013	66
Thereafter	18
Executory costs and imputed interest included in payments	(321)
	1,409
Current portion of capital lease liability	(690)
	\$ 719

For the year ended March 31, 2008, \$0.1 million of interest paid on capital leases is included in interest expense (2007: nil).

9. Share capital:

(a) Authorized:

1,000,000	Class A voting common shares, without par value
1	Class B voting common share, without par value
80,000	Class C non-voting, 8% cumulative preferred shares, with a par value of \$1,000 per share, convertible to Class A shares upon the sale of the outstanding Class B share by the initial shareholder. Special rights attached to the Class C shares restrict the Company's ability to issue shares and to declare dividends.

(b) Issued and outstanding:

AS AT MARCH 31	2008		2007	
	NUMBER OF SHARES	AMOUNT \$	NUMBER OF SHARES	AMOUNT \$
Class B, common	1	\$ 1	1	\$ 1
Class C, preferred	75,477	75,477	75,477	75,477
		\$ 75,478		\$ 75,478

(c) Dividends:

Dividends on the Class C cumulative preferred shares, if declared, are payable annually on March 31 of each year. All dividend entitlements to date have been paid.

Notes to Consolidated Financial Statements

10. Ferry service fees:

The Company entered into an agreement with the Province of British Columbia commencing April 1, 2003 to provide ferry services that would not be commercially viable under the current regulated tariff structure. In exchange for fees, the Company provides agreed ferry service levels on specified routes and administers certain social policy initiatives on behalf of the Province. The agreement is for a period of sixty years, the details of which are renegotiated after a first term of five years and each four-year term thereafter. During the year ended March 31, 2007 the agreement was amended and the province agreed to increase fees for provision of ferry service on northern routes commencing April 1, 2007.

During the year ended March 31, 2008, the Company entered into an agreement with the Province under which the Province agreed to reimburse the Company for the major refit of the *M.V. Nicola*, which provides service on the Prince Rupert – Lax Kw'alaams route, to a maximum of \$1.6 million. This major refit is scheduled to occur once every four years. As at March 31, 2008, the cost of the refit totalled \$0.5 million. This amount has been recorded as owing from the Province and as a reduction of maintenance expense.

11. Federal-Provincial Subsidy Agreement:

The Company receives revenue provided to the Province of British Columbia from the Government of Canada pursuant to a contract between the federal and provincial governments for the provision of ferry, coastal freight and passenger services in the waters of British Columbia. The annual payment increases with the Vancouver Consumer Price Index.

12. Interest rate support:

The Government of Canada has agreed to provide \$9.9 million in the form of interest rate support to the Company for major refurbishments on three vessels (2007: \$9.9 million). For the year ended March 31, 2008 \$2.1 million has been recorded as a reduction of interest expense (2007: \$4.7 million). For the year ended March 31, 2007 \$0.5 million was also recorded as a reduction of capitalized interest.

The Company has no requirement to repay these funds, other than as a result of an event of default under the agreement with the Government of Canada.

13. Extraordinary gain:

On March 22, 2006 the vessel *Queen of the North* ran aground and subsequently sank. During the fiscal quarter ended June 30, 2006, the Company settled with its hull and machinery insurance providers and received insurance proceeds, net of deductible, of \$67.9 million in settlement of the claim. At March 31, 2006, \$6.6 million of the proceeds from this claim had been recognized to offset insurable losses (including \$4.3 million net book value of capital assets) incurred as a result of this event.

14. Other commitments:

The Company entered into an agreement to lease office space commencing March 1, 2008 for a term of five years with two successive renewal options of five years each. Rental expenses charged to administration expenses for the year ended March 31, 2008 were \$0.1 million.

Future minimum lease payments:

YEAR ENDED	
2009	\$ 722
2010	722
2011	722
2012	722
2013	662
	\$ 3,550

15. Risk management:

(a) Fuel management:

The Company may manage its exposure to vessel fuel price volatility by entering into swap agreements with certain financial intermediaries in order to add a fixed component to the inherent floating nature of fuel prices. When fuel hedging instruments are used, it is solely for the purpose of reducing fuel price risk, not for generating trading profits. Gains and losses resulting from the contracts are recognized as a component of fuel costs (also see note 4).

(b) Credit and interest rate risk:

Management does not believe that the Company is subject to any significant concentration of credit risk. Most of the Company's receivables result from tickets sold to passengers through the use of major credit cards. These receivables are short-term, generally being settled shortly after sale. The Company manages the credit exposure related to financial instruments by selecting credit-worthy counter-parties and by limiting its exposure to a single counter-party.

The Company may enter into interest rate agreements to manage its exposure on debt instruments. As at March 31, 2008, the Company has no interest rate agreements.

(c) Foreign exchange risk:

The Company may enter into foreign exchange forward contracts to manage its exposure on future purchase commitments. As at March 31, 2008, the Company has entered into foreign exchange forward contracts valued at Cdn \$296.3 million that are payable in Euros (2007: \$586.8 million). Of these contracts, \$132.8 million (2007: \$416.8 million) is for the committed cost, including customs and duty of the new "Super C" Class vessels, and \$163.5 million (2007: \$170.0 million) is for the committed cost, including customs and duty of the new Northern vessel.

Notes to Consolidated Financial Statements

(d) Fair value of financial instruments:

The fair value of financial instruments not currently carried at market value is summarized in the following table. Judgement is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates determined as of March 31, 2008 and 2007, are not necessarily indicative of the amounts the Company could have realized in current markets.

Fair market values have been estimated by reference to quoted market prices for the actual or similar instruments where available. Where market prices are not available fair values are estimated using discounted cash flow analysis based on the Company's

indicative borrowing costs. The fair values of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities, short-term debt, accrued employee costs, and interest payable on long-term debt approximate their carrying amounts due to their short term to maturity.

As at March 31, 2008, the Company had outstanding fuel hedges with a notional amount of \$25.9 million (2007: \$5.8 million) which are marked to market and recognized in the consolidated financial statements at a value of \$1.8 million (2007: \$0.7 million).

The carrying values and approximate fair market values of the Company's longer term financial instruments are:

AS AT MARCH 31	2008		2007	
	CARRYING VALUE	APPROX FMV	CARRYING VALUE	APPROX FMV
Assets:				
Foreign currency forward contracts	\$ 16,373	\$ 16,373	\$ -	\$ -
Liabilities:				
Long-term debt	1,028,872	1,080,846	749,628	804,155
Foreign currency forward contracts	-	-	2,831	10,052
Obligations under capital lease	1,409	1,409	138	138

16. Related party transactions:

In accordance with the Act, the Company is responsible for paying any expenses that are incurred by its parent, B.C. Ferry Authority ("BCFA"), without charge. During the year ended March 31, 2008, the Company paid \$51,117 (2007: \$14,437) of such expenses.

The Province of British Columbia owns the Company's 75,477 non-voting preferred shares, but has no voting interest in either the Company or its parent, BCFA.

17. Contingent liabilities:

The Company, in conducting its usual business activities, is involved in various legal proceedings and litigation, the outcome of which is indeterminable. It is the Company's policy to carry adequate insurance to minimize the financial risk associated with such matters. Management is of the opinion that the aggregate net liability, if any, of these proceedings and litigation would not be significant to the Company. Any additional future costs or recoveries, which differ from the accrued amounts, will be recorded as expenses or revenues as determined.

Corporate Directory

BC FERRIES

BOARD OF DIRECTORS

(effective April 1, 2008)

Elizabeth J. Harrison, QC
Chair

Thomas W. Harris ^{2, 3}
Vice Chair

Douglas E. Allen ^{1, 3}

Mark L. Cullen ^{2, 3}

Christopher C. Gardner ^{1, 2}

David L. Hahn

Donald P. Hayes ^{1, 4}

Brian G. Kenning ^{1, 3}

Gordon R. Larkin ⁴

Maureen V. Macarenko ^{2, 4}

A. Daniel Miller ^{3, 4}

Wayne H. Stoilen ^{1, 4}

Graham M. Wilson ^{1, 2}

COMMITTEES (MEMBERSHIP EFFECTIVE JUNE 13, 2008)

1 Audit & Finance Committee

2 Governance & Nominating Committee

3 Human Resources & Compensation Committee

4 Safety, Health, Environment & Security Committee

BOARD OF DIRECTORS

(effective April 1, 2007 - March 31, 2008)

Elizabeth J. Harrison, QC
Chair

Thomas W. Harris
Vice Chair

Douglas E. Allen

Mark L. Cullen (effective February 7, 2008)

Sandy M. Fulton

David L. Hahn

Donald P. Hayes (effective February 7, 2008)

John R. Henderson

Doreen J. Hewitt

Brian G. Kenning (effective February 7, 2008)

Gordon R. Larkin (effective October 1, 2007)

Maureen V. Macarenko

Robert W. McCaskill

A. Daniel Miller (effective May 15, 2007)

Wayne H. Stoilen (effective February 7, 2008)

G. Raymond Whitehead (deceased June 11, 2007)

Graham M. Wilson

SENIOR OFFICERS OF THE COMPANY

(effective April 1, 2008)

David L. Hahn
President & Chief Executive Officer

Robert P. Clarke
Executive Vice President & Chief Financial Officer

Michael J. Corrigan
Executive Vice President & Chief Operating Officer

William R. Cottick
Executive Vice President, Corporate Affairs & General Counsel

Glen N. Schwartz
Executive Vice President, Human Resources &
Corporate Development

Captain Trafford M. Taylor
Executive Vice President, New Vessel Construction
& Industry Affairs

OFFICERS OF THE COMPANY

(effective April 1, 2008)

Captain George A. Capacci
Vice President, Fleet Operations

Mark F. Collins
Vice President, Engineering

Geoffrey H. Dickson
Vice President, Food & Retail Operations

L. Blaine Ellis
Vice President, Employee Relations

M. Alana Gallagher
Treasurer

Cynthia M. Lukaitis
Vice President & Corporate Secretary

Captain D.W. James Marshall
Vice President, Safety, Security & Environment

Mark S. Stefanson
Vice President, Public Affairs

Corrine E. Storey
Vice President, Terminal Operations

Daniel Wong
Vice President, Corporate Relations

B.C. FERRY AUTHORITY 2007/08 ANNUAL REPORT

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A Message From The Chair

The B.C. Ferry Authority is an independent, no-share corporation that holds the single issued voting share of British Columbia Ferry Services Inc. The Authority appoints the Board of Directors of British Columbia Ferry Services Inc. Currently, the members of the B.C. Ferry Authority Board are also directors of British Columbia Ferry Services Inc.

The B.C. Ferry Authority is governed by the *Coastal Ferry Act*, which establishes a process for the appointment of directors to ensure broad regional representation. In accordance with the Act, the Authority has a nine-member Board of Directors comprised of individuals with a wide range of experience.

Four directors are appointed from nominations received from four appointment areas, comprised of 13 coastal regional districts. In addition, one director is appointed from nominations from the union representing the employees of British Columbia Ferry Services Inc., two directors are appointed from the community-at-large and two additional directors are appointed by the provincial government.

The Board adheres to the highest corporate governance standards in its deliberations.



Elizabeth J. Harrison, QC
Chair

B.C. Ferry Authority 2007/08 Annual Report

The B.C. Ferry Authority (the "Authority") is a corporation without share capital that owns the single issued voting share of the operating company, British Columbia Ferry Services Inc. ("BCFS"). The Province of British Columbia is the holder of all of the preferred shares of BCFS. The Authority appoints the Board of Directors of BCFS.

The Authority is established and governed by the *Coastal Ferry Act* (the "Act"). In accordance with the Act, the Authority has adopted high standards of public and stakeholder accountability that require the Authority's financial and operating performance, as well as its process for appointing qualified individuals to serve as directors, to be open to public view.

Appointment of Directors

The Authority has a nine-member Board of Directors, the required composition of which is set out in the Act and includes regional and stakeholder representation. Four directors are appointed by the Board from nominees of four Appointment Areas, comprised of coastal regional districts, and one director is appointed from the nominees of the BC Ferry & Marine Workers' Union (BCFMWU), the trade union representing the employees of BCFS.

The Board also includes two directors appointed by the Province of British Columbia and two additional directors appointed by the Board from members of the community-at-large.

The Act requires that the terms of three directors of the Authority expire each year. The first appointments to the Board were staggered such that three appointments were made for each of one, two and three years. Directors may serve for up to two consecutive terms (or three consecutive terms in the case of current directors who served on the first Board of the Authority). At present, as a matter of Board policy, the directors of the Authority are also directors of the operating company, BCFS.

Directors appointed from the Southern Mainland and Southern Vancouver Island appointment areas, as well as one director appointed by the Province of British Columbia, had terms expiring March 31, 2008. During the year, the Board sought and received nominations of qualified individuals to serve as directors from the two appointment areas. One nominee from each of the two appointment areas was selected and appointed to serve on the Board for a three-year term commencing April 1, 2008. As well, the Province of British Columbia appointed a director to serve for a three-year term.

Also during the year, Director Ray Whitehead, a long-time member of the Board who served as a nominee of the BCFMWU, passed away after a courageous battle with lung cancer. Following this loss on June 11, 2007, the Board sought and received nominations from the BCFMWU of qualified individuals to serve as a replacement director. A nominee was selected and appointed to serve on the Board effective October 1, 2007. Under the Act, a replacement director is to hold office until the end of the term of the departing director (and may be appointed as a director for one further term only). In accordance with the Act, this appointment was made for a term ending March 31, 2010.

In selecting individuals to serve as directors of the Authority, two primary objectives continued to guide the deliberations of the Board. The first objective was to ensure that the composition of the Board meets the requirements of the Act and the second was to ensure that collectively, the Board includes individuals with the skills and experience necessary to ensure the sound performance of the Authority and the effective interaction and operation of the Board. The specific criteria that guided the Board in its appointment process during the year are reflected in the Skills and Experience Profile adopted by the Authority and included as Schedule A to the General Bylaws of the Authority. The General Bylaws of the Authority are available for public view at: www.bcferryauthority.com. There were no amendments made to the bylaws during the year.

Meetings

The Board meets regularly to conduct its business. During the year, the Board and its Committees met on 27 occasions, including the Annual General Meeting of the Authority held in accordance with section 18 of the Act. A summary of the meetings of the Board and its Committees follows.

Summary of Meetings 2007/08

DATE	TYPE	OUTCOMES
April 27, 2007	Nominating Committee	• Terms of reference for the Nominating Committee recommended for approval to the Governance Committee • Terms of reference for the engagement of external consultants to provide assistance to the Nominating Committee approved • Process for seeking candidates for appointment to the Board effective April 1, 2008 discussed
June 5, 2007	Audit & Finance Committee	• Financial statements of the Authority for the year ended March 31, 2007 recommended for approval to the Board • Independence letter and findings report on the audit process received from the External Auditor
June 5, 2007	Nominating Committee	• Status of process for seeking candidates for appointment to the Board effective April 1, 2008 discussed
June 6, 2007	Governance Committee	• Report from the Chair of the Governance Committee on the review of conflict of interest forms submitted by Directors and Officers of the Authority • Report from the Chair of the Governance Committee on written declarations of the Directors of BCFA attesting to their independence • Terms of reference for the Nominating Committee recommended for approval to the Board • Amendments to the terms of reference for the Governance Committee recommended for approval to the Board • Amendments to various sections of the Board Governance Manual recommended for approval to the Board
June 7, 2007	Board of Directors	• Financial statements of the Authority for the year ended March 31, 2007 approved • Terms of reference for the Nominating Committee approved • Amendments to the terms of reference for the Governance Committee approved • Amendments to various sections of the Board Governance Manual approved • Process for seeking candidates for appointment to the Board effective April 1, 2008 discussed • General Counsel authorized to execute, on behalf of the Authority, the shareholder's unanimous consent resolutions pertaining to all of the business required to be transacted at the Annual General Meeting of British Columbia Ferry Services Inc. • 2007 Annual General Meeting of the Authority discussed • 2006/07 Annual Report of the Authority approved
June 21, 2007	Nominating Committee	• Skills and experience of the Board reviewed • Process and timeline for seeking a replacement director from nominations of the trade union representing the employees of British Columbia Ferry Services Inc. discussed • Status of process for seeking candidates for appointment to the Board effective April 1, 2008 discussed
June 29, 2007	Nominating Committee	• Status of process for seeking candidates for appointment to the Board effective April 1, 2008 discussed
July 23, 2007	Nominating Committee	• Status of process for seeking a replacement director from nominations of the trade union representing the employees of British Columbia Ferry Services Inc. discussed • Status of process for seeking candidates for appointment to the Board effective April 1, 2008 discussed
August 23, 2007	Audit & Finance Committee	• Financial statements of the Authority for the three months ended June 30, 2007 recommended for approval to the Board

Summary of Meetings 2007/08

DATE	TYPE	OUTCOMES
August 23, 2007	Board of Directors	- Financial statements of the Authority for the three months ended June 30, 2007 approved 2007 Annual General Meeting of the Authority discussed
September 4, 2007	Nominating Committee	- Status of process for seeking a replacement director from nominations of the trade union representing the employees of British Columbia Ferry Services Inc. discussed - Status of process for seeking candidates for appointment to the Board effective April 1, 2008 discussed
September 11, 2007	Audit & Finance Committee	Appointment of lead external audit partners recommended for approval to the Board
September 11, 2007	Governance Committee	Compensation for Chair of the Nominating Committee recommended for approval to the Board
September 11, 2007	Nominating Committee	- Appointment of a Director nominated by the trade union representing the employees of British Columbia Ferry Services Inc. for the term October 1, 2007–March 31, 2010, recommended for approval to the Board - Status of process for seeking candidates for appointment to the Board effective April 1, 2008 discussed
September 13, 2007	Board of Directors	- Lead external audit partners appointed - Compensation for Chair of the Nominating Committee approved - Nominee of the trade union representing the employees of British Columbia Ferry Services Inc. appointed a Director of the Authority for the term October 1, 2007–March 31, 2010 - Nominee of the trade union representing the employees of British Columbia Ferry Services Inc. appointed a Director of British Columbia Ferry Services Inc. effective October 1, 2007 - Status of process for seeking candidates for appointment to the Board effective April 1, 2008 discussed
September 13, 2007	Annual General Meeting	Annual General Meeting held pursuant to the Coastal Ferry Act (section 18)
November 20, 2007	Audit & Finance Committee	- Financial statements of the Authority for the six months ended September 30, 2007 recommended for approval to the Board 2007/08 terms of engagement for the external auditor approved - Audit & Finance Committee terms of reference reviewed - Audit & Finance Committee meeting dates for 2008/09, 2009/10 and 2010/11 approved
November 20, 2007	Nominating Committee	Status of process for seeking candidates for appointment to the Board effective April 1, 2008 discussed
November 20, 2007	Governance Committee	- Terms of reference for the Board of Directors, Board Chair and Governance Committee reviewed - Board Governance Manual reviewed and amendments recommended for approval to the Board - Governance Committee meeting dates for 2008/09, 2009/10 and 2010/11 approved - Changes in Director compensation effective April 1, 2008 recommended for approval to the Board - Report from the Chair of the Governance Committee on the review of conflict of interest and independence forms submitted by Directors

Summary of Meetings 2007/08

DATE	TYPE	OUTCOMES
November 28, 2007	Board of Directors	- Financial statements of the Authority for the six months ended September 30, 2007 approved - Status of process for seeking candidates for appointment to the Board effective April 1, 2008 discussed - Amendments to the Board Governance Manual approved - Board meeting dates for 2008/09, 2009/10 and 2010/11 approved - Changes in Director compensation effective April 1, 2008 approved
January 31, 2008	Nominating Committee	Nominees of the Southern Vancouver Island & Southern Mainland Appointment Areas recommended for appointment to the Board for three-year terms effective April 1, 2008
February 7, 2008	Board of Directors	- Status of process for seeking candidates for appointment to the Board effective April 1, 2008 discussed - Number of Directors of British Columbia Ferry Services Inc. increased from twelve to sixteen effective February 7, 2008 - Four Directors appointed to the Board of British Columbia Ferry Services Inc. effective February 7, 2008
February 20, 2008	Audit & Finance Committee	- Financial statements of the Authority for the nine months ended December 31, 2007 recommended for approval to the Board 2008/09 operating budget of the Authority recommended for approval to the Board
February 21, 2008	Governance Committee	- Audit & Finance Committee terms of reference reviewed - Composition of Board Committees discussed
February 27, 2008	Board of Directors	2008/09 operating budget of the Authority approved - Financial statements of the Authority for the nine months ended December 31, 2007 approved - Changes in lead external audit partners approved - Results of the Board of Directors' 2007/08 self assessment evaluation reviewed and discussed
March 27, 2008	Governance Committee	- Appointments of Chair and Vice Chair effective April 1, 2008 recommended for approval to the Board - Committee structure, Chairs and membership effective April 1, 2008 recommended for approval to the Board - Committee Chairs' remuneration effective April 1, 2008 recommended for approval to the Board
March 27, 2008	Board of Directors	- Nominees of the Southern Vancouver Island & Southern Mainland Appointment Areas appointed to the Board for three-year terms effective April 1, 2008 - Chair and Vice Chair effective April 1, 2008 appointed - Committee structure, Chairs and membership effective April 1, 2008 approved - Committee Chairs' remuneration effective April 1, 2008 approved - Number of Directors of British Columbia Ferry Services Inc. decreased from sixteen to thirteen effective April 1, 2008 - Directors of British Columbia Ferry Services Inc. effective April 1, 2008 appointed

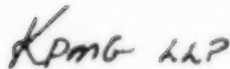
Auditors' Report

To the Board of Directors, B.C. Ferry Authority

We have audited the statement of financial position of B.C. Ferry Authority as at March 31, 2008 and the statements of operations and changes in net assets for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Authority as at March 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants

Victoria, Canada

May 16, 2008

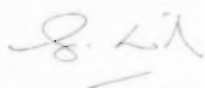
Financial Statements

STATEMENT OF FINANCIAL POSITION (EXPRESSED IN THOUSANDS)

AS AT MARCH 31		2008		2007	
Assets					
Investment in British Columbia Ferry Services Inc.	\$	235,104	\$	203,570	
	\$	235,104	\$	203,570	
Net Assets					
Invested in common share of British Columbia Ferry Services Inc.	\$	1	\$	1	
Accumulated undistributed earnings of British Columbia Ferry Services Inc.		235,103		203,569	
	\$	235,104	\$	203,570	

See accompanying notes to financial statements.

On behalf of the Board:



Director, Graham M. Wilson



Director, Elizabeth J. Harrison, QC

STATEMENT OF OPERATIONS (EXPRESSED IN THOUSANDS)

YEARS ENDED MARCH 31	2008		2007	
Revenue:				
Distributable earnings of British Columbia Ferry Services Inc. (note 2)	\$	31,534	\$	104,019
Expenses:				
Administration		51		14
Recovery from British Columbia Ferry Services Inc. (note 3)		(51)		(14)
Excess of revenue over expenses				
	\$	31,534	\$	104,019

See accompanying notes to financial statements.

STATEMENT OF CHANGES IN NET ASSETS (EXPRESSED IN THOUSANDS)

	INVESTED IN BCFSI		UNDISTRIBUTED EARNINGS OF BCFSI		TOTAL
Balance, March 31, 2007	\$	1	\$	203,569	\$ 203,570
Excess of revenue over expenses		-		31,534	31,534
Balance, March 31, 2008	\$	1	\$	235,103	\$ 235,104

See accompanying notes to financial statements.

Notes to Financial Statements

(EXPRESSED IN THOUSANDS)

B.C. Ferry Authority (the "Authority") was established by the *Coastal Ferry Act* (British Columbia) (the "Act") on April 1, 2003 as a corporation without share capital. The Authority is governed by a board of nine directors. The board of directors appoints replacements for outgoing directors for seven of the positions as follows:

- four appointed from nominees provided to the board by each of the four appointment areas consisting of those coastal regional districts that the Lieutenant Governor in Council for British Columbia may prescribe, with one director appointed from each area;
- one appointed from nominees provided by the trade union representing the employees of the British Columbia Ferry Services Inc. ("BCFSI");
- two appointed from qualified individuals as defined in the Act.

The Lieutenant Governor in Council for British Columbia appoints the other two director positions from qualified individuals as terms expire. The terms of three director positions expire each fiscal year.

The Authority's primary purpose is to hold the share of BCFSI, a company incorporated under the *Company Act* (British Columbia) by way of conversion on April 2, 2003, and which now validly exists under the *Business Corporations Act* (British Columbia). BCFSI's primary business is the provision of coastal ferry services in British Columbia. The Province of British Columbia (the "Province") contributed the initial capital to the Authority to fund the purchase of the BCFSI common share. The Act provides that upon a sale of the common share of BCFSI held by the Authority, the Province is to be repaid its initial contribution and the Authority is dissolved. The Act also provides that upon dissolution of the Authority, all remaining assets of the Authority, if any, vest in the Province.

1. Significant accounting policies:

(a) Basis of presentation:

The financial statements are prepared in accordance with Canadian generally accepted accounting principles for not-for-profit entities. The Authority's investment in its wholly owned subsidiary, BCFSI is accounted for by the equity method. Under the equity method the original cost of the investment is adjusted for the Authority's share of post-acquisition earnings or losses less dividends.

(b) Adoption of new accounting standards:

Effective April 1, 2007, the Authority adopted the Canadian Institute of Chartered Accountants (CICA) Handbook Sections 3251 "Equity," 3855 "Financial Instruments - Recognition and Measurement," 3861 "Financial Instruments - Disclosure and Presentation," and 3865 "Hedges." These new Handbook Sections provide comprehensive requirements for the recognition and measurement of financial instruments, as well as standards on when and how hedge accounting may be applied.

Under these new standards, all financial instruments are classified as one of the following five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities.

The Authority did not hold any financial instruments at either April 1, 2007 or March 31, 2008. Accordingly, the adoption of these standards had no effect on the financial statements for the twelve months ended March 31, 2008.

(c) Revenue recognition:

The Authority follows the deferral method of accounting for contributions. The Authority does not expect to receive endowment contributions.

(d) Taxes:

The Authority and BCFSI are exempt from federal and provincial income taxes.

(e) Statement of Cash Flows:

A statement of cash flows has not been included with these statements as it does not provide additional information.

(f) Future accounting changes:

CICA has issued two new accounting standards that become effective for the Authority beginning April 1, 2008; Handbook Section 3862 "Financial Instruments - Disclosure" and Handbook Section 3863 "Financial Instruments - Presentation."

Sections 3862 and 3863 replace the current Handbook Section 3861 "Financial Instruments - Disclosure and Presentation." The new sections revise and enhance the current disclosure requirements and require disclosure about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

The Authority does not expect application of this section to have any impact on the financial statements.

Notes to Financial Statements

2. Distributable earnings of British Columbia Ferry Services Inc.:

The distributable earnings of BCFSI consist of the current period net earnings, less any dividends paid in the current period and less a reserve for undeclared preferred share dividend, if any.

YEARS ENDED MARCH 31	2008	2007
Net earnings of BCFSI	\$ 37,094	\$ 110,057
Dividends paid on 8% cumulative preferred shares	(6,038)	(6,038)
Adjustment to the accumulated undistributed earnings of BCFSI (a)	478	-
	\$ 31,534	\$ 104,019

- (a) Effective April 1, 2007, BCFSI adopted the Canadian Institute of Chartered Accountants (CICA) Handbook section 3855 "Financial Instruments – Recognition and Measurement." This resulted in a restatement of opening retained earnings at April 1, 2007 to recognize the prior years' earnings effect of accounting for long-term debt using the effective interest method.

3. Recovery from British Columbia Ferry Services Inc.:

The Act provides that BCFSI is responsible for paying any expenses that are incurred by the Authority.

4. Subsidiary supplemental information:

The consolidated financial position and operating results for BCFSI and its wholly-owned subsidiaries are summarized below:

AS AT MARCH 31	2008	2007
Current assets	\$ 209,171	\$ 237,590
Capital and other assets	1,341,280	978,185
	\$ 1,550,451	\$ 1,215,775
Current liabilities	\$ 180,350	\$ 170,402
Accrued employee future benefits	13,020	13,755
Unrealized losses on derivative instruments	-	2,831
Regulatory liabilities	16,833	-
Other long-term liabilities	76	-
Long-term debt and capital lease obligations	1,029,591	749,740
	1,239,870	936,728
Shareholders' equity		
Common share held by the Authority	1	1
Preferred shares (a)	75,477	75,477
Retained earnings	235,103	203,569
	310,581	279,047
	\$ 1,550,451	\$ 1,215,775

YEARS ENDED MARCH 31	2008	2007
Revenue (including gains)	\$ 640,859	\$ 657,895
Expenses (including losses)	603,765	547,838
Net earnings	\$ 37,094	\$ 110,057
Cash flows from operating	\$ 123,661	\$ 160,460
Cash flows from financing	256,632	266,775
Cash flows from investing	(430,007)	(249,403)

- (a) The outstanding non-voting, 8% cumulative preferred shares are held by the Province and are convertible to common shares upon a sale of the outstanding common share. Special rights attached to the preferred shares restrict BCFSI's ability to issue share capital and to declare dividends.

Corporate Directory

B.C. FERRY AUTHORITY

BOARD OF DIRECTORS

(effective April 1, 2008)

Elizabeth J. Harrison, QC

Chair

(Community-at-large appointment)

Thomas W. Harris²

Vice Chair

(Central Vancouver Island & Northern Georgia Strait appointment area)

Douglas E. Allen¹

(Community-at-large appointment)

Christopher C. Gardner^{1,2}

(Province of British Columbia appointment)

Donald P. Hayes¹

(Southern Vancouver Island appointment area)

Brian G. Kenning¹

(Southern Mainland appointment area)

Gordon R. Larkin

(Organized labour appointment)

Maureen V. Macarenko²

(Northern Coastal & North Island appointment area)

Graham M. Wilson^{1,2}

(Province of British Columbia appointment)

COMMITTEES (MEMBERSHIP EFFECTIVE JUNE 13, 2008)

1 Audit & Finance Committee

2 Governance & Nominating Committee

BOARD OF DIRECTORS

(effective April 1, 2007 – March 31, 2008)

Elizabeth J. Harrison, QC

Chair

Thomas W. Harris

Vice Chair

Douglas E. Allen

Sandy M. Fulton

John R. Henderson

Doreen J. Hewitt

Gordon R. Larkin (effective October 1, 2007)

Maureen V. Macarenko

G. Raymond Whitehead (deceased June 11, 2007)

Graham M. Wilson

OFFICERS

(effective April 1, 2008)

Elizabeth J. Harrison, QC

Chair

Thomas W. Harris

Vice Chair

William R. Cottick

Executive Vice President, Corporate Affairs & General Counsel

Cynthia M. Lukaitis

Vice President & Corporate Secretary



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